



Corporate Governance

VOLUME TWO: APPENDICES TO THE CODE OF BEST PRACTICE

for Consumer Co-operative Societies
in membership of Co-operatives^{UK}

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Introduction to the Appendices

The following appendices should be read in conjunction with volume one of the code. Societies will not be monitored against their compliance with the appendices; they are designed to be used as a guidance tool for societies wishing to draft their own model terms of references, job descriptions etc.

Many of the appendices are based on the best practice governance guidance documents produced by the Institute of Chartered Secretaries and Administrators (ICSA). ICSA has produced these guidance documents for the use of listed companies who are required by the Listing Rules to report on their compliance with the Combined Code; because of this some of the terms of reference for committees of the board may be too onerous or prescriptive for the use of your society. However, Co-operatives^{UK} believes this document provides a useful handbook of recommended governance best practice and societies are encouraged to adapt these appendices to their own circumstances.

Appendix 1

MEMBERS' RIGHTS AND RESPONSIBILITIES

The governance of co-operative societies originates from their members. As member-owned businesses co-operatives should seek to involve members as much as possible in the governance of the business. The way this can be achieved is by ensuring that members are aware of their rights and responsibilities, and by ensuring a sufficient dialogue is maintained between the society and the members.

The first half of this Appendix is taken from Co-operative^{UK}'s original Corporate Governance Code of Best Practice (1995). It is a comprehensive list of the rights and responsibilities of members of co-operative societies. The Appendix then goes on to list information that should be provided for members. This list is not designed to be exhaustive but should give an idea of what information should be available to members to allow them to keep abreast of their society's financial and co-operative performance, and allows them to make an educated vote during board elections.

This Appendix also includes a section at the end which gives a brief explanation of the term 'active' members, as defined by Ian Snaith, member of the Corporate Governance Review Group, Cobbetts Consultant and lecturer at Leicester University.

1. Members have the right to: -

- 1.1 Be involved in the democratic decision making within the society to:
 - 1.1.1 Attend members' meetings
 - 1.1.2 Vote in society elections;
 - 1.1.3 Stand for election (subject to qualification) and participate in the democratic process
 - 1.1.4 Voice an opinion and be consulted on key decisions affecting the society;
 - 1.1.5 Make proposals to improve the society's activities.
- 1.2 Share in the benefits arising from the trading success of the society;
- 1.3 Have access to member education and training opportunities;
- 1.4 Have access to information which should be provided in keeping with co-operative values and heritage;
- 1.5 Be informed of their rights; and
- 1.6 Enjoy equal treatment with other members.

2. Members have a responsibility to: -

- 2.1 Abide by the rules of the society;
- 2.2 Use the services of the society;
- 2.3 Not act to the detriment of the society;
- 2.4 Accept that their co-operative is a distinctive membership organisation;
- 2.5 Acknowledge and subscribe to the values and principles set out in the Statement of Co-operative Identity of the International Co-operative Alliance;

- 2.6 Ensure the continuance of their society as a co-operative organisation
- 2.7 Hold the board to account by questioning and criticising where necessary its actions and decisions;
- 2.8 Encourage others to join the society and use its services;
- 2.9 Learn more about the society, its values, structure and aspirations;
- 2.10 Take an interest in the governance of the society and vote in director elections and attend Annual General Meetings where possible;
- 2.11 To seek and develop useful means of exchanging information with the society and make use of occasions or routes of communication that provide for this exchange; and
- 2.12 Inform the society of local events, conditions and opportunities that might affect the operation of the society.

The exercise and discharge of these rights and responsibilities in a responsible fashion will ensure that the identity of the society as a co-operative is maintained.

3. Information to be made available to members (which may be met by making it available on request and placing the information available on the society's website):

- 3.1 The dates, times and venues of members' meetings
- 3.2 Any further member information, offers in store and member related activities in the local area
- 3.3 The annual report and interim report. This should include: -
 - 3.3.1 A summary financial statement illustrating the profitability, growth, gearing and return on capital employed of the business
 - 3.3.2 A summary of the Key Social and Co-operative Performance Indicators
 - 3.3.3 Any recommendations of the Corporate Governance Code of Best Practice that have not been complied with and reasons for non-compliance.
- 3.4 The terms of reference of the search, remuneration and audit committees, explaining their role and the authority delegated to them by the board
- 3.5 The terms and conditions of appointment of professional external directors
- 3.6 Where remuneration consultants are appointed, a statement of whether they have any connection with the society

4. During a board election members should be provided with: -

- 4.1 Sufficient biographical details about candidates to enable members to take an informed decision on their election or re-election
- 4.2 Where the society operates a postal ballot, papers should be sent out at least twenty-one days in advance
- 4.3 If the board has decided that it would like to have the opportunity to co-opt directors onto the board, the reasons for their decision to co-opt should be given to the members, and they should be given the opportunity to vote on this decision.
- 4.4 On re-election, confirmation from the chair that, following performance evaluation, the individual's performance continues to be effective and to

demonstrate commitment to the role, including completing the minimum twelve hours training per year, and attendance of board and committee meetings on a regular basis.

5. 'Active' Members

The board has a duty to give all the society's members the opportunity both to be well informed about their society's activities and to participate in its affairs. However, the society should seek to communicate more fully and directly with those members who are already active in trading with the co-operative, investing in it, or participating in its democratic processes.

Appendix 2

REPORTING LINES FOR THE SECRETARY AND HIS/HER CORPORATE GOVERNANCE ROLE AND DUTIES

The secretary of a co-operative society is a key member of the executive team appointed by the board of directors as an officer of the society with specific responsibility to the society as a whole for its sound governance and for the guidance of the board in its responsible and effective execution of its tasks. In its Code of Best Practice the Cadbury Committee¹ states (subsequently incorporated as Article A5.3 of the Combined Code):²

“All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are followed and that applicable rules and regulations are complied with.”

As an officer of the society at the centre of the decision making process, the society secretary is in a powerful position of influence. The secretary should assist and guide the directors in their pursuit of creating a viable co-operative business; he/she should also act with integrity and independence to protect the interests of the society, its members and its employees. Today’s society secretary should play a pro-active and central role in the governance of the society.

The following guidance is in two parts. The first part emphasises the importance of having a clear reporting line for the secretary; the second part comprises a list of the main ‘corporate governance’ activities carried out by the secretary. It is taken from the Institute of Chartered Secretaries and Administrators UK Guidance Notes and Best Practice Guides.³ There are many other matters for which the secretary will often be responsible and the extent of his/her duties will depend on the particular society.

Except in the case of small societies, it is accepted best practice that the individual who holds the office of chief executive should not hold the office of secretary.

1. Reporting lines for the secretary

Boards of directors have a right to expect the secretary to give impartial advice and to act in the best interests of the society. However, it is incumbent upon boards to ensure that secretaries are in a position to do so, for example by ensuring that they are not subject to the undue influence of one or more of the directors. If the board fails to protect the integrity of the secretary’s position, one of the most effective in-built internal controls available to the society is likely to be seriously undermined.

¹ Paragraph 1.6 of the Code of Best Practice: *Report of the Committee on the Financial Aspects of Corporate Governance*, 1992.

² *The Combined Code on Corporate Governance* (July 2003) A5.3

³ http://www.icsa.org.uk/news/guidance_uk.php

- 1.1 The secretary is responsible to the board and should be accountable to the board on all matters relating to his/her duties as an officer of the society. In between board meetings his/her first point of contact is the chair.
- 1.2 If, in addition to the core duties as listed below, the secretary has other executive or administrative duties, he/she should report to the chief executive or such other member of the management executive to whom responsibility for that matter has been delegated by the board.
- 1.3 The secretary's salary and benefits should be settled (or at least noted) by the board as a whole.

2. The Secretary's Corporate Governance Responsibilities

The secretary's responsibilities include:

- 2.1 Ensuring the smooth running of the board's and board committees' activities by helping the chair to set agendas, preparing papers and presenting papers to the board and board committees, advising on board procedures and ensuring the board follows them.
- 2.2 Keeping under close review all legislative, regulatory and corporate governance developments that might affect the society's operations, and ensuring the board is fully briefed on these and that it has regard to them when taking decisions.
- 2.3 Arranging appropriate insurance cover in respect of potential legal action against its directors.
- 2.4 Preparing and filing the society's annual return.
- 2.5 Making all the necessary entries in all registers required by the society's rules or the Industrial and Provident Societies Act to be kept by the society. These include:
 - 2.5.1 maintaining an accurate and up to date membership register; and
 - 2.5.2 maintaining a fully updated register of directors' and members of the management executive's material interests

Such registers should be made available to members on request.

- 2.6 Where one exists, to keep custody of the society's seal.
- 2.7 Ensuring that the interests of members and other stakeholders (particularly employees) are in the board's mind when important business decisions are being taken.
- 2.8 Ensuring that the board takes an active role in implementing and monitoring Co-operatives^{UK} Key Social and Co-operative Performance Indicators and advising the board in relation to its reporting on this matter.
- 2.9 Acting as a confidential sounding board to the chair and directors on points that may concern them, and to take a lead role in managing difficult inter-personal issues on the board.
- 2.10 Acting as a primary point of contact and source of advice and guidance for directors as regards the society and its activities in order to support the decision making process.

- 2.11 Acting as an additional enquiring voice in relation to board decisions which particularly affect the society, drawing on his/her experience and knowledge of the practical aspects of management including law, tax and business finance.
- 2.12 Ensuring that, where applicable, the recommendations of Co-operatives^{UK}'s Corporate Governance Code of Best Practice are observed and that the compliance report is signed off by him/herself, the chair and the chief executive.
- 2.13 Inducting new directors into the business and their roles and responsibilities.
- 2.14 Ensuring that directors update their skills and knowledge on an ongoing basis to fulfil their role on the board, and where appropriate on any board committees they may sit on.
- 2.15 Making arrangements for and managing the whole process of the Annual General Meeting (AGM) and establishing, with the board's agreement, the items to be considered at the AGM, including resolutions dealing with governance type matters.
- 2.16 Acting as Returning Officer and, unless otherwise provided in the society's Rules, being responsible for the conduct of all elections and referenda contemplated by the Rules. The secretary, acting as Returning Officer, and working in conjunction with the external verifier (e.g. if Electoral Reform Services are involved in the election), shall be solely and absolutely responsible for settling the form of notices, resolutions, proposals, voting cards and voting papers for the purpose of ensuring that the results of all matters put to the vote either by way of a show of hands or card system or referendum be clear and conclusive.

Appendix 3

ANNUAL REPORT CHECKLIST

The annual report is one of the most important documents a society produces and is an important tool for communicating with members and other stakeholders. The following checklist is based on the Combined Code's Schedule C which sets out the corporate governance disclosure requirements of listed companies.⁴

The annual report should open with the society's vision and adherence to the International Co-operative Alliance Mission Statement. The annual report should be clearly written so as to be easily understood by members and the board should consider the format of the report to ensure it is legible for people who are visually impaired.

The annual report should record:

- A statement of how the board operates, including a high level statement of which types of decisions are taken by the board and which are delegated to the management executive
- The names of the chair, the deputy chair(s), the elected directors, any co-opted professional external directors, the chairs and members of the membership, search, audit and remuneration committees and any other committees of the board which may exist and the names of the chief executive, secretary and members of the management executive
- The number of meetings of the board and its committees, and individual attendance by directors
- The other significant commitments/directorships of board members and members of the management executive and any conflicts of interests such as relationships with suppliers etc.
- How performance evaluation of the board, its committees and its directors has been conducted and the results of this evaluation
- Whether any elections to the main board or any regional/area or other committees of the society were uncontested and any action being carried out by the board to encourage further participation of member in the governance of their society

The annual report should also include: -

- A separate section describing the work of the search committee, where one exists, including the process it has used in relation to the co-option of professional external directors
- A separate section describing the work of the membership committee

⁴ *The Combined Code on Corporate Governance* (July 2003) Schedule C p.23

- A separate section describing the work of the remuneration committee
- If the remuneration committee has obtained external advice on remuneration/fees this process should be explained
- Details of the remuneration packages of the society's chief executive, members of the management executive, professional external directors and the fees of individual elected directors' should be provided in the annual report.
- Any compensation payments for loss of office that have been made to any members of the management executive and any inconsistencies with their current employment contracts should be disclosed in full in the annual report.
- In instances where a member of the management executive has a service contract of over twelve months the reasons for this must be stated
- An explanation from the directors of their responsibility for preparing the financial statements and the governance compliance report and a statement by the auditors about their reporting responsibilities
- A statement from the directors that the business is a going concern, with supporting assumptions or qualifications as necessary
- A report that the board has conducted a review of the effectiveness of the society's system of internal controls
- A separate section describing the work of the audit committee in discharging its responsibilities
- Where there is no internal audit function, the reasons for the absence of such a function
- Where the board does not accept the audit committee's recommendation on the appointment, reappointment or removal of an external auditor, a statement from the audit committee explaining the recommendation and a statement from the board explaining reasons why it has taken another decision
- An explanation of how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded
- A description of the work of any other committees of the board
- A description of the mechanisms in place to retain control over any trading subsidiary business
- An outline of any director or potential director training conducted by the society, or outside organisation
- Any recommendations from the Corporate Governance Code of Best Practice that the society has failed to comply with, and the reasons for non-compliance
- Progress made in monitoring the ten Co-operatives^{UK} Key Social and Co-operative Performance Indicators

Disclosure of corporate governance arrangements

Co-operatives^{UK} requires a statement to be included in the annual report relating to compliance with the Code. The chief executive, chair/president and secretary should sign off this statement.

Appendix 4

CODE OF BEST PRACTICE ON WITHDRAWABLE SHARE CAPITAL (Rec. A3)

The amended code was approved by the board of Co-operatives^{UK} on 20th April 2005, the Financial Services Authority have subsequently provided advisory comments as to the content, which are now being considered

Introduction

- 1 The Code sets out the minimum standards of good practice to be observed by all Industrial and Provident Societies ("societies") in their acceptance of Withdrawable Share Capital (WSC) In accordance with clause (f) this code was reviewed in December 2004 and amended in March 2005.
- 2 The governing principles of this Code are:
 - a) To set out the standards of good practice, which societies will follow in their acceptance of WSC and in their dealings with members;
 - b) That in the conduct of their business, societies will act fairly and reasonably in all their dealings with their members in relation to WSC;
 - c) That societies will help members to understand how their WSC accounts operate;
 - d) To maintain confidence in the security and integrity of their acceptance of WSC, societies recognise that their systems and technology need to be reliable to protect their members and themselves.
- 3 The Code requires societies to provide certain information to members. This will usually be at the time when an account is opened. Information will also be available to members from branches, if any, of the societies.

Code of Conduct

a) Opening an Account

1. Societies will satisfy themselves about the identity of any persons seeking to open a WSC account to assist in protecting their members and themselves against fraud.
2. Societies will provide to prospective members details of the identification needed.
3. Members and prospective members must be informed in writing at the earliest opportunity as follows:-

"This society abides by a code of practice which requires it to provide a statement to its shareholders of the nature of their investment and any change

affecting it. The position you occupy as a shareholder of x society is no different from that of a shareholder in any other corporate body in the sense that, if x society fails, you may not have all, or any of your investment returned to you. [Those societies that have share protection schemes may wish to insert a sentence to that effect here, but they should ensure that they take legal advice before doing so, to ensure that the statement is accurate and fair in relation to the society's specific arrangements.] Your investment is withdrawable without penalty at the discretion of the Board. The society, unlike banks and building societies, is not subject to prudential supervision by the Financial Services Authority.

If you have any questions regarding the code please address them to:-

X Society Name and Address

[Each Society should include here the address of their Registered Office and relevant Department.]”

b) Terms and Conditions other than Interest

1. Written terms and conditions of WSC will be expressed in plain language and will provide a fair and balanced view of the relationship between the member and the society.
2. Societies will tell members how any variation of the terms and conditions will be notified. Societies will give members 30 days' notice before any variation takes effect.
3. Societies should issue to their members, if there are sufficient changes in a 12 - month period to warrant it, a single document to provide a consolidation of the variations made to their terms and conditions over that period.
4. Societies will not close the WSC account of any member without first giving 30 days' notice.
5. A copy of a summary of the latest Annual Report containing an appropriate audit report will be available to every member on demand for no charge.

c) Interest

1. Societies will provide members with details of the interest earned by their WSC. These will be in the form of published tariffs which will be available in branches or on request.
2. Societies will tell members the basis on which interest is calculated and when it will accrue or be added to their account. Societies will explain also the basis on which they may vary interest rates.
3. When societies change interest rates with immediate effect they will publicise those changes by notices in their branches.

d) Advertising of WSC

1. Societies in their advertising and promotional material will tell members and potential members that their intended investment will be subject to approval by the society concerned.
2. Societies will act responsibly in marketing their WSC. All advertising will comply with the spirit and letter of the British Code of Advertising Practice, the British Code of Sales Promotion Practice, and other relevant Codes of Practice of similar standing.

In particular societies will ensure that all advertising and promotional literature is fair and reasonable, does not contain misleading information and complies with all relevant legislation.

It is incumbent on societies to ensure that members are made fully aware that their capital is subject to risk as capital is in an equity-based business.

3. For the purpose of this Code the term "advertisement" includes press and broadcast advertisements, direct marketing, window displays, posters, brochures, leaflets, websites and automated teller machine displays.
4. Advertisements must conform to the requirements of clause (b)1 above.
5. Advertisers of WSC must take special care to ensure that members of the general public are fully aware of the nature of any commitment into which they may enter as a result of responding to an advertisement.
6. The registered or business name (and, in the case of press advertisement, direct marketing, brochures and leaflets, the address) of the society must be clearly stated.
7. Rates of interest shall not be advertised unless they are described appropriately; the following terms should be used:-

- a) "Y% gross"
- b) "Z% compounded annual rate"

Where-

- a) Y is the contractual rate of interest payable not taking account of income tax; an explanatory phrase conveying this meaning must be used to qualify the rate quoted. The member must also be informed that although the interest is paid gross it is liable to tax.
- b) Z is the rate equivalent to a "gross" rate annualised to take account of the compounding of interest paid other than once a year; an explanatory phrase conveying this meaning must be included if the "compounded annual rate" is quoted. "CAR", following a percentage rate, is acceptable as the abbreviation of "compounded annual rate". A "CAR" must not be quoted without the relevant "gross" rate. A "CAR" must not have greater prominence in size or type or otherwise than the other rate quoted.

8. It follows from paragraph 7 that all advertisements in which a rate is quoted must include the contractual rate, i.e. the "gross" rate. No rate shall be given greater prominence in size or type or otherwise than the contractual rate provided interest is due at least annually. Where rates are quoted on the basis of other than a 12 - month period, this must be clearly stated.
9. Advertisements quoting a rate of interest must contain a specific statement indicating the frequency of payment of interest; and either that
 - (i) the rate quoted is fixed for any term specified; or
 - (ii) interest rates are subject to variation.
10. Advertisements quoting a rate of interest which are intended for media or direct mail with long copy dates must contain a suitable qualification, such as "rate correct at time of going to press", and may state that time.
11. The explanatory phrases and statements required by this Code must be clearly audible or legible as appropriate.
12. A general notice to members of changes in rates (or a simple list of the range of accounts and their rates) displayed in offices on a rate board, primarily to fulfil contractual obligations, need only comply with paragraphs 7 and 8 of the Code. In the case of such notices or lists, the word "gross" and "CAR" as appropriate need not appear after each rate. However, it must be clear from the whole of the notice or list which term applies to which rate, for example, by the use of column headings or footnotes.
13. Where interest is forfeited on any withdrawal without notice, words such as "instant access" or "immediate withdrawals" must not be displayed together with the rate of interest without clear qualification.
14. For accounts which do not allow withdrawals, even after notice, without forfeiting interest, the text of the advertisement must include a statement indicating that, if a withdrawal is made, the stated interest rate will not be achieved.
15. Where a maximum or minimum amount must be received to achieve the stated interest rate, the text of the advertisement must include a clear statement to this effect.
16. Advertisements must:-
 - a) include the full terms and conditions or state that they are available on request;
 - b) clearly state in any part of the advertisement to be retained by the consumer a full postal address at which the advertiser can be contacted during normal business hours and the description and details of the advertised product including the information required by this Code.

e) Complaints

When societies receive a complaint about the operation of this code, they must investigate it promptly and efficiently. They should notify the complainant of the procedures being adopted, and of the means of redress if they are not satisfied with the initial investigation.

f) **Monitoring and Compliance**

This code is drawn up by Co-operatives^{UK} and is subject to review every two years. Compliance with this code will be supervised as part of the monitoring procedure for corporate governance already established by Co-operatives^{UK} for its member societies in the 'Corporate Governance Code of Best Practice'.

Appendix 5

MATTERS RESERVED FOR THE BOARD

An effective board controls the business but delegates day-to-day responsibility to the management executive. Directors need to remind themselves constantly of the distinction between 'direction' and 'management'. Whilst the distinction is not always clear-cut, it is critical that there should be an all round awareness of it. Only by working together can directors and professional managers create the appropriate conditions for a successful co-operative business. The board and management executive must function as a team. It is vital that they have trust and respect one another in their respective roles. The society's rules should clearly specify the respective duties and responsibilities of the board and of the management executive. Periodically, the board should consider those matters which require its approval.

There are a number of matters which are required, or that in the interests of the society, can be decided only by the board as a whole. The Combined Code states that, "There should be a formal schedule of matters specifically reserved for [the board's] decision"⁵. It is incumbent upon the board to make it clear what these Matters Reserved for the board are. Without a clear and documented statement, the board may find itself faced with some difficulties in attempting to discipline executives and/or seek redress, in circumstance where the board considers that transactions have been undertaken, the authority for which is open to question. The board must ensure that any schedule of reserved matters is provided to the management executive.

The notes which follow attempt to provide a model schedule of matters that could be reserved for the board's approval in medium to large-sized primary consumer co-operative Societies. They are taken from the Institute of Chartered Secretaries and Administrators UK Guidance Notes and Best Practice Guides⁶ and appendix one of the original Corporate Governance Code of Best Practice (1995). It is recognised that the relative importance of some matters included in this appendix will vary according to the size and nature of the society's business.

Multiple signatures

In drawing up a schedule of Matters Reserved for the board, societies should clarify which transactions require multiple board signatures on the relevant documentation.

Delegation

Some of the matters included in this appendix should, under the recommendations of the Cadbury committee and/or Combined Code, be the responsibility of the audit, search or

⁵ *The Combined Code* (July 2003) A1.1 p. 5

⁶ http://www.icsa.org.uk/news/guidance_uk.php

remuneration committees. However, full delegation is not permitted in these cases, as the final decisions on the matter are required to be taken by the whole board.

Urgent matters

In drawing up a schedule of Matters Reserved for the board it is important to establish procedures for dealing with matters which often have to be dealt with urgently, often between scheduled board meetings. If the matter is routine and discussion is not necessary the approval of all the directors may be obtained by means of a written resolution. In all cases however the procedures should balance the need for urgency with the overriding principle that each director should be given as much information as possible, the time to consider it properly and an opportunity to discuss the matter prior to the commitment of the society.

The following schedule has been produced to assist boards of directors and society secretaries in preparing a schedule of Matters Reserved for the Board in accordance with good corporate governance practice.

1. Membership Issues

- 1.1 All matters concerning the determination and operation of the society's rules
- 1.2 Reporting to members – i.e. frequency, location and content of members' meetings and directors' reports
- 1.3 Profit distribution policies and determination for members' approval
- 1.4 All aspects of membership policy and achievements, including interface with any member committees where appropriate
- 1.5 Encourage the growth of membership and its involvement in the affairs of the society in recognition that co-operative societies are membership based
- 1.6 Approval of resolutions and corresponding documentation to be put forward to members at a general meeting.

2. Strategy and Management

- 2.1 Responsibility for ensuring that the society's affairs are conducted in accordance with its rules, the best interests of the society and its members, and in accordance with Co-operative Values and Principles
- 2.2 Approval of the society's long term objectives and commercial strategy.
- 2.3 Approval of the annual operating and capital expenditure budgets and any material changes to them.
- 2.4 Oversight of the society's operations ensuring:
 - 2.4.1 Competent and prudent management
 - 2.4.2 Sound planning
 - 2.4.3 An adequate system of internal control
 - 2.4.4 Adequate accounting and other records
 - 2.4.5 Compliance with statutory and regulatory obligations

- 2.5 Review of performance in the light of the society's strategy, objectives, business plans and budgets and ensuring that any necessary corrective action is taken.
- 2.6 Approval of the extension of the society's activities into new business or geographic areas.

3. Financial reporting and controls

- 3.1 Approval of preliminary announcements of interim and final results
- 3.2 Approval of the annual report and financial statements (including the corporate governance statement and remuneration report)
- 3.3 Approval of any changes in accounting policies or practices.

4. Internal Controls

- 4.1 Ensuring maintenance of a sound system of internal control and risk management including:
 - 4.1.1 Receiving reports on, and reviewing the effectiveness of, the society's risk and control processes to support its strategy and objectives
 - 4.1.2 Undertaking an annual assessment of these processes
 - 4.1.3 Approving an appropriate statement for inclusion in the annual report

5. Contracts

- 5.1 Approval of Capital Expenditure – a clear statement of delegated authority is essential. The board should reserve the right to approve specifically each expense which is larger than 0.05 per cent of society turnover, i.e. £50,000 in a society with £100m turnover. Sums lower than this will not require specific board approval provided that all such items are covered by the overall capital budget approved by the board.
- 5.2 Approval of all business acquisitions and disposals.
- 5.3 Approval of all property acquisitions and disposals.
- 5.4 Approval of all land and building leasing transactions.
- 5.5 Approval of all funding arrangements proposed for the society. In general, directors should seek independent external advice before considering proposals for property sale and leaseback transactions.
- 5.6 Approval of all openings and closings of either branches or member services, but not for changes to merchandise ranges in branches.

6. Constitution of the board and senior personnel appointments

- 6.1 Ensuring adequate succession planning for the management executive
- 6.2 Selection of the chair and vice-chair(s) of the board

- 6.3 Appointment of the chief executive, including terms and delegated authority, his/her performance appraisal and his/her removal from office including compensation terms for loss of office.
- 6.4 Approval of the management structure.
- 6.5 Membership and chairs of board committees.
- 6.6 Appointment or removal of the society secretary
- 6.7 Appointment, reappointment or removal of the external auditor to be put to members for approval, following the recommendation of the audit committee.
- 6.8 Appointments to boards of subsidiaries.
- 6.9 Approval and review of the society's personnel policies.

7. Directors' fees and remuneration

- 7.1 Determining the fee level for the directors which will be approved by members.
- 7.2 Determining the remuneration of the chief executive, society secretary and other senior executives, following the recommendations of the remuneration committee.
- 7.3 Determining the remuneration of the professional external directors following the recommendations of the remuneration committee, subject to the society Rules and member approval as appropriate.

8. Delegation of Authority

- 8.1 The division of responsibilities between the board and the management executive, which should be in writing.
- 8.2 Approval of the terms of reference of board committees.
- 8.3 Receiving reports from board committees on their activities.

9. Corporate Governance Matters

- 9.1 Undertaking a formal and rigorous review [annually] of its own performance, that of its committees and individual directors.
- 9.2 Considering the balance of interests between members, employees, customers, suppliers and the community.
- 9.3 Review of the society's overall corporate governance arrangements.
- 9.4 Receiving reports of the views of the society's members.

10. Policies

- 10.1 Approval of policies, including:
 - 10.1.1 Directors' Code of Conduct
 - 10.1.2 Health and Safety policy
 - 10.1.3 Tendering policy
 - 10.1.4 Personnel policy, including any training structures in place

- 10.1.5 Communications policy
- 10.1.6 Key Social and Co-operative Performance Indicator policy
- 10.1.7 Work with other co-operatives
- 10.1.8 Charitable donations policy

11. Other

- 11.1 The making of political donations
- 11.2 Approval of the appointment of the society's principal professional advisers
- 11.3 Approval of the overall levels of insurance for the society including directors' and officers' liability insurance [and indemnification of directors]
- 11.4 General policy on the use of litigation and major decisions on any particular piece of litigation capable of having a substantial financial bearing or impact on the reputation of the society
- 11.5 Changes to the rules of the society's pension scheme, or changes of trustees or (when this is subject to the approval of the society) changes in the fund management arrangements.
- 11.6 This schedule of matters reserved for board decisions.
- 11.7 Approval of any changes to the business's structure i.e. any new subsidiaries etc.
- 11.8 Communication with the Co-operative Employers Association on NACO terms and conditions of employment.

In addition, the board will receive reports and recommendations from time to time on any matter which it considers significant to the society.

Appendix 6

TERMS OF REFERENCE – THE SEARCH COMMITTEE

The Combined Code on Corporate Governance states that:

“There should be a nomination committee which should lead the process for board appointments and make recommendations to the board”⁷.

Although a democratic system exists in the co-operative sector to determine membership of the board, Co-operatives^{UK} recognises the value of establishing a nomination committee, or as it is termed in this code, a search committee, to enable the board to identify skills gaps on the board and manage the search programme for co-opted directors. The search committee should evaluate the balance of skills, knowledge and experience on the board. After undertaking this evaluation, it should prepare a recommendation to the board on the profile of individuals that would be required to fill any significant skills shortages. The search committee should also have responsibility for establishing a succession plan for the key positions on the management executive of chief executive and secretary.

Societies should go through a formal process of reviewing the balance and effectiveness of their boards, identifying the skills lacking, and the individuals that may need to be co-opted who would best provide them. In particular the committee must assess the time commitments of the board posts and ensure that the individual has sufficient time to undertake them. This appendix is based on the Institute of Chartered Secretaries and Administrators UK Guidance Notes and Best Practice Guidance Note on nomination committees.⁸

1. Membership

- 1.1 Members of the committee shall be appointed by the board and shall be made up of at least [3] members.
- 1.2 Only members of the committee, and the secretary (or the person nominated to service the committee) have the right to attend committee meetings. However, other individuals such as the chief executive, the head of human resources and external advisers may be invited to attend for all or part of any meeting, as and when appropriate.
- 1.3 Appointments to the committee shall be for a period of up to three years, which may be extended for two further three-year periods.
- 1.4 The board shall appoint the committee chair. In the absence of the committee chair and/or an appointed deputy, the remaining members present shall elect one of their number to chair the meeting. The chair of the board shall not chair the

⁷ *The Combined Code on Corporate Governance* – July 2003 A.4.1

⁸ <http://www.icsa.org.uk/pdfs/guidance/031021.pdf>

committee when it is dealing with the matter of succession to the chair.

2. Secretary

2.1 The society secretary, or their nominee, shall act as the secretary of the committee.

3. Quorum

3.1 The quorum necessary for the transaction of business shall be [2]. A duly convened meeting of the committee at which a quorum is present shall be competent to exercise all or any of the authorities, powers and discretions vested in or exercisable by the committee.

4. Frequency of Meetings

4.1 The committee shall meet [at least twice a year] and at such other times as the chair of the committee shall require ⁹.

5. Notice of Meetings

5.1 Meetings of the committee shall be summoned by the secretary of the committee at the request of the chair of the committee.

5.2 Unless otherwise agreed, notice of each meeting confirming the venue, time and date, together with an agenda of items to be discussed, shall be forwarded to each member of the committee, any other person required to attend and all other directors, no later than one week before the date of the meeting. Supporting papers shall be sent to committee members and to other attendees as appropriate, at the same time.

6. Minutes of Meetings

6.1 The secretary, or his/her chosen representative, shall minute the proceedings and resolutions of all committee meetings including the names of those persons in attendance.

6.2 Minutes of committee meetings shall be circulated promptly to all members of the committee and the chair of the board and, once agreed, to all other members of the board, unless a conflict of interest exists.

⁹ The frequency and timing of meetings will differ according to the needs of the society. Meetings should be organised so that attendance is maximised (for example by timetabling them to coincide with board meetings).

7. Annual General Meeting

- 7.1 The chair of the committee, or a nominated deputy, shall attend the Annual General Meeting¹⁰ and be prepared to respond to any member questions on the committee's activities.

8. Duties

- 8.1 The committee shall:
- 8.1.1 Regularly review the structure, size and composition (including the skills, knowledge and experience required) of the board compared to its current position and make recommendations to the board with regard to the need for the appointment of any co-opted professional external directors;
 - 8.1.2 Inform the society secretary of any skills deficiencies on the board and ensure that the necessary training be provided;
 - 8.1.3 From time to time inform the membership of any identified skills gaps, and advertise for those members with the requisite qualities to come forward for election;
 - 8.1.4 Give full consideration to succession planning for co-opted directors and senior executives in the course of its work, taking into account the challenges and opportunities facing the society, and what skills and expertise are therefore needed on the board in the future;
 - 8.1.5 Be responsible for identifying and nominating for the approval of the board, candidates for co-opted director vacancies as and when they arise;
 - 8.1.6 Before the board makes an appointment of a co-opted professional external director, evaluate the balance of skills; knowledge and experience on the board, and, in the light of this evaluation prepare a description of the role and capabilities required for a particular appointment. In identifying suitable candidates the committee shall:
 - 8.1.6.1 use open advertising or the services of external advisers to facilitate the search, including those recommended by Co-operatives^{UK};
 - 8.1.6.2 consider candidates from a wide range of backgrounds; and
 - 8.1.6.3 consider candidates on merit and against objective criteria, taking care that appointees have enough time available to devote to the position;
 - 8.1.7 Keep under review the leadership needs of the organisation, with a view to ensuring the continued ability of the organisation to compete effectively in the marketplace;
 - 8.1.8 Keep up to date and fully informed about strategic issues and commercial changes affecting the society and the market in which it operates;

¹⁰ Where a society helpfully holds an AGM over a number of locations, the chairs of board committees, or their nominated deputies, should attend, at least, the final meeting.

- 8.1.9 Review annually the time required from all directors. Performance evaluation should be used to assess whether all directors are spending enough time to fulfil their duties; and
 - 8.1.10 Ensure that on appointment to the board, all directors receive a formal letter of appointment setting out clearly what is expected of them in terms of time commitment, committee service and involvement outside board meetings.
- 8.2 The committee shall also make recommendations to the board concerning:
- 8.2.1 Formulating plans for succession for members of the management executive in particular for the key role of chief executive;
 - 8.2.2 Membership of the audit and remuneration and any other board committees, in consultation with the chairs of those committees;
 - 8.2.3 The re-appointment of any co-opted professional external director at the conclusion of their specified term of office having given due regard to their performance and ability to continue to contribute to the board in the light of the knowledge, skills and experience required;
 - 8.2.4 Any matters relating to the continuation in office of any director at any time including the suspension or termination of service of an executive director (where the chief executive and chief finance officer sit on the board), as an employee of the society subject to the provisions of the law and their service contract.

9. Reporting Responsibilities

- 9.1 The committee chair shall report formally to the board on its proceedings after each meeting on all matters within its duties and responsibilities.
- 9.2 The committee shall make whatever recommendations to the board it deems appropriate on any area within its remit where action or improvement is needed.
- 9.3 The committee shall make a statement in the annual report about its activities, the process used to make appointments to the management executive and co-opted professional external directors, and explain if external advice or open advertising has not been used.

10. Other

- 10.1 The committee shall, at least once a year, have performance, constitution and terms of reference reviewed, to ensure it is operating at maximum effectiveness. This evaluation should recommend any changes it considers necessary to the board for approval.

11. Authority

- 11.1 The committee is authorised to seek any information it requires from any employee of the society, via the secretary, in order to perform its duties.
- 11.2 The committee is authorised to obtain, at the society's expense, outside legal or other professional advice on any matters within its terms of reference.

Appendix 7

SAMPLE LETTER OF APPOINTMENT FOR NEWLY ELECTED AND/OR CO-OPTED PROFESSIONAL EXTERNAL DIRECTORS

The Combined Code now requires the terms of appointment of non-executive directors to be available for inspection. Co-operatives^{UK} recognises the value of providing new directors of co-operative societies with a letter of appointment which lays out what will be expected of them. The following letter is designed to be a guide for societies and may need to be altered to the requirements of the needs of a particular society. It is based on the Sample Letter of Non-Executive Director Appointment as provided in Higgs Suggestions for Good Practice.¹¹

Dear [name of appointee]

I write to confirm your appointment as a director of [name of society] with effect from [date].

As you are aware there are a number of formal matters connected with this appointment which now have to be dealt with. This letter deals with these formalities and is accompanied by an induction pack of information to assist you in your new role.

Appointment

Your term of office will be for an initial tenure of three years commencing on [date], unless otherwise terminated earlier. Continuation of your position on the board is contingent on re-election, at forthcoming Annual General Meetings/annual ratification of the appointment, by members at the Annual General Meeting.

Time Commitment

Overall we anticipate a time commitment of [number] hours per month after the induction phase. This will include attendance at least ten board meetings per year, the AGM(s), [one] annual board away day, [at least two] training days and [at least one] one site visit per year. Additional involvement may include representing [name of society] at other events, including the Annual Co-operative Congress and the Co-operative Group's AGM. Most board members also take on other roles, usually by serving on one or more of the board's committees. You will also be expected to devote appropriate preparation time ahead of each meeting.

By accepting this appointment, you have confirmed that you are able to allocate sufficient

¹¹ *The Combined Code* (July 2003) Higgs Suggestions for Good Practice, p. 71-74

time to meet the expectations of your role. The agreement of the board should be sought before accepting additional commitments that might impact upon the time you are able to devote to your role as a co-operative director.

Role

The board as a whole is collectively responsible for the success of the society. The board:

- Has a direct responsibility to ensure that the society carries out its commitment to be a bona fide co-operative and adheres to the International Co-operative Alliance Statement of Co-operative Identity.
- Should help develop and approve proposals on strategy.
- Should constructively challenge and hold the management executive to account. Directors should scrutinise the performance of the management executive, through the chief executive, in meeting agreed goals and objectives and should monitor the reporting of performance.
- Should ensure that controls and systems of risk management are robust and defensible.
- Is responsible for ensuring that people with the best possible commercial and financial acumen, who have an affinity with the co-operative mode of business, are leading the management team.

All directors must take decisions objectively in the interests of the society.

Fees

You will be paid a fee of £[amount] gross per annum, which will be subject to an annual review by the board and put to a members' vote on an annual basis. The society will reimburse you for all reasonable and properly documented expenses you incur in performing the duties of your office.

Declaration of interests

It is accepted and acknowledged that you may have business interests other than those of the society and must declare any conflicts that are apparent at present on the enclosed Declaration of Interests form [see Appendix 9, part two]. In the event that you become aware of any potential conflicts of interest, these should be disclosed to the chair and society secretary immediately as they become apparent.

Confidentiality

All information acquired during your term of office is confidential to the society and should not be released, either during your appointment or following termination (by whatever means), to third parties without prior clearance from the secretary. Please sign the enclosed confidentiality agreement. [See Appendix 9, Part 2 – Code of Conduct]

Induction

Immediately after appointment, the society will provide a comprehensive, formal and tailored induction. This will include the information pack recommended by Co-operatives^{UK} and listed in Appendix 12. We will also arrange for site visits and meetings with the management executive and the society's auditors.

Review Process

The performance of individual directors and the whole board and its committees is evaluated annually. If, in the interim, there are any matters which cause you concern about your role you should discuss them with the secretary as soon as is appropriate.

Insurance

The society has directors' and officers' liability insurance and it is intended to maintain such cover for the full term of your appointment. The current indemnity limit is £ [amount].¹²

Independent Professional Advice

Occasions may arise when you consider that you need professional advice in the furtherance of your duties as a director. Circumstances may occur when it will be appropriate for you to seek advice from independent advisors at the society's expense. A copy of the board's agreed procedure under which directors may obtain such independent advice is attached.¹³ The society will reimburse the full cost of expenditure incurred in accordance with the society's expenses policy.

Committees

This letter refers to your appointment as a director of the society. In the event that you are also asked to serve on one or more of the board committees this will be covered in a separate communication setting out the committee(s)'s terms of reference and any specific responsibilities that may be involved.

In conclusion, may I take this opportunity to congratulate you on your election/appointment to the board and to remind you that I am available at any time to provide such support and information as you may need.

Yours sincerely

Secretary

¹² A copy of the society's policy should be attached with this letter.

¹³ The society should devise its own policy on independent advice which should be attached with the letter of appointment.

Appendix 8

DUE DILIGENCE FOR DIRECTORS

The Higgs review, published in January 2003, recommended that before accepting an appointment, a prospective non-executive director should undertake his/her own thorough examination of the company to satisfy themselves that it is an organisation in which they can have faith and in which they will be well suited to working¹⁴.

Co-operatives^{UK} also recommends this policy for members wishing to stand for election to the board and for those co-opted external directors.

The following questions are not intended to be exhaustive, but are intended to be a helpful basis for the pre-appointment due diligence process that all co-operative directors should undertake. They are taken from the Institute of Chartered Secretaries and Administrators' UK Guidance Notes and Best Practice Guides.¹⁵

Questions for Potential Directors to ask

The business

- What is the society's current financial position and what has its financial track record been over the last three years?
- What is the exact nature and extent of the society's business activities?
- What is the society's competitive position and market share in its main business areas?

Governance

- What record does the society have on corporate governance issues?
- Does the society have sound and effective systems of internal control?
- What is the size and structure of the board and any board committees and what are the relationships between the board and the chief executive and secretary, and the management team?
- What is the society's attitude towards, and relationship with, its members?

The role of the director

- If the society is not performing particularly well is there the potential to turn it round and do I have the time, desires and capability to make a positive impact?
- Am I satisfied that the size, structure and make-up of the board will enable me to make an effective contribution?
- Would accepting the directorship put me in a position of having a conflict of interest?

¹⁴ *Review of the role and effectiveness of non-executive directors* Derek Higgs, January 2003, Annex G pg. 105

¹⁵ http://www.icsa.org.uk/news/guidance_uk.php

- Do I have the necessary knowledge, skills, experience and time to make a positive contribution to the board of this society?
- Will I be provided with sufficient training to enable me to perform my role to the best of my ability?

Risk management

- Is there anything about the nature and extent of the society's business activities that would cause me concern both in terms of risk and personal ethical consideration?
- Is any material litigation presently being undertaken or threatened, either by the society or against it?
- Am I satisfied that the internal regulation of the society is sound and that I can operate effectively within its stated corporate governance framework?
- What insurance cover is available to directors and what is the society's policy on indemnifying directors?
- What professional advice is available to directors to enable them to carry out their duties?

Appendix 9

THE DUTIES OF DIRECTORS AND DIRECTORS' CODE OF CONDUCT

The position of director of a co-operative society carries many demanding and important duties that need to be recognised before appointment and throughout a director's period of office. Directors owe a duty to the society, not to individual members or employees. Directors are bound by legal duties, and failure to carry out those duties can result in personal liability. These can be divided into statutory duties, fiduciary duties and duties of care. This appendix is divided into two sections. Part one sets out the duties and responsibilities of the directors of co-operative societies and the part two is an outline code of conduct for directors.

1. Duties and Responsibilities of Directors

This part sets out the legal duties and responsibilities of directors of co-operative societies. It is only a summary, and if directors are in any doubt about their duties, or any aspect of performance of their duties, they should consult the secretary.

- 1.1 Directors have important legal duties, and failure to carry out these duties can result in personal liability.
- 1.2 Broadly there are four categories of legal duty as follows, and a brief summary of these duties is set out below:
 - 1.2.1 the duty to obey relevant laws and regulations;
 - 1.2.2 the duty of good faith;
 - 1.2.3 the duty to take care and
 - 1.2.4 the duty to maintain the co-operative status of the organisation.

Obeying the law

- 1.3 Various Acts of Parliament and statutory provisions impose direct obligations upon directors and upon the society itself. These cover such areas as occupational health and safety, employee relations, equal opportunity for employees, competition, consumer protection, the environment, and keeping proper accounting records.
- 1.4 Although directors do not carry executive responsibility for ensuring that statutory requirements are met, they are responsible as a board for ensuring that others take executive responsibility and discharge it. Where they fail to ensure this, directors can become subject to statutory penalties and personal liability.
- 1.5 Directors have a direct and personal responsibility for ensuring that the society does not continue to trade if it is insolvent. Again, failure to discharge this responsibility can result in personal liability.

Duty of good faith

- 1.6 A director is in a position like that of a trustee – namely being responsible for somebody else's (the society's) property. As a result the law imposes on directors a duty of good faith, which can broadly be summarised as follows:
- 1.6.1 truthfulness and honesty – this involves acting with complete truthfulness and honesty in any dealings with or on behalf of the society;
 - 1.6.2 treating the society's affairs as confidential. Individual directors have no legal authority to disclose anything outside the boardroom except what is already in the public domain, or what they are expressly authorised by the board to disclose;
 - 1.6.3 acting at all times in the best interests of the society – this means ensuring that the society's interests always come first, and that a director never uses their position to obtain a benefit or advantage for themselves, for other people or other organisations;
 - 1.6.4 avoiding conflicts of interest – a director should avoid putting themselves in a position where their duties and responsibilities as a director conflicts with other personal interests. Where a conflict arises, they must comply with the society's rules.¹⁶

Duty to take care

- 1.7 In carrying out their responsibilities, directors must take proper care. They are expected to show
- 1.7.1 such skill and care in carrying out their responsibilities as a person having their background and experience would reasonably be expected to show (the subjective test), and
 - 1.7.2 the levels of skill and care that a person carrying out that role would reasonably be expected to show (the objective test).
- 1.8 In other words, they are not expected to be experts, but they are expected to use such expertise as they have. Furthermore, directors must recognise that an objective standard is applied, which means that where they do not have the knowledge and expertise needed, they should either undergo training, or should bring additional skills onto the board, possibly through co-option.
- 1.9 The duty to take proper care includes the following:
- 1.9.1 reading board papers before meetings, and coming to meetings properly prepared;
 - 1.9.2 asking questions if further explanation or information is needed, and challenging the executives when not satisfied with the answers given;
 - 1.9.3 taking advice both from the executives and from independent advisors when that is needed for the best interests of the society;

¹⁶ The rules should provide that directors disclose any material interest to the board. If the rules do not provide this, the law is that directors must disclose any material interests to the members.

- 1.9.4 doing their best – directors should aim for the highest standards they can achieve. It is not acceptable to leave things to other people, to fail to attend meetings, or to treat other matters as more important than those of the society. A director who does not give an appropriate level of commitment to the society’s affairs is failing in their duty;
- 1.9.5 undergoing appropriate training and development. It is not sufficient to rely on current knowledge and experience. In order to keep pace with changing needs, and changing legal and financial obligations, directors need to ensure that they are properly equipped to carry out their responsibilities.

2. Code of Conduct for Directors

This part sets out the standards of personal behaviour and conduct required of directors of co-operative societies. A society’s rules should require its board of directors to adopt a code of conduct, and to enforce compliance with it. This code may be adopted for these purposes, and it may be adapted to suit local needs and circumstances.

Status of this Code of Conduct

- 2.1 This is the Code of Conduct for directors referred to in the society’s rules. It has been approved by the board of directors.
- 2.2 Every director will sign an acknowledgement accepting their obligation to comply with this Code including its provisions covering confidentiality. Candidates seeking election as director will be asked to confirm that they have read it, and if elected will sign a similar acknowledgement.

Qualification for office

- 2.3 The society’s rules set out the criteria by which an individual is eligible to be a director. A director shall notify the secretary immediately on becoming aware that they are or may no longer be eligible to be a director.

Commitment to Co-operative Principles

- 2.4 The society is established to provide goods and services to its members as a co-operative.
- 2.5 Each of the directors will discharge their responsibilities in a way which seeks to ensure that the society remains committed to following Co-operative Values and Principles.

Carrying out their responsibilities

- 2.6 Being a director brings a commitment to carry out all necessary duties and responsibilities which must be performed by the board. Each director will do the following:

- 2.6.1 attend on time at every meeting of the board and of any committee or sub-committee of the board to which they are appointed. Any director who, without good reason accepted by the remaining directors, fails to attend more meetings than the board allows¹⁷, will be in material breach of this Code;
- 2.6.2 prepare properly for every meeting by reading in advance any documents sent out for the purpose of the meeting;
- 2.6.3 accept decisions made by the board, even if they disagree with it and voted against it. This includes a commitment to support any decision of the board outside the boardroom.

Standards of behaviours

- 2.7 In addition to fulfilling their legal duties, directors are expected to show appropriate standards of behaviour in carrying out their responsibilities. This is necessary in order that the board can function properly as a board, that it can play its appropriate part in the society's overall governance, and that the society's good name and reputation in the community is maintained.
- 2.8 Directors will observe the following general standards:
 - 2.8.1 in their dealings with each other, with the society's officers, and with its employees and members, treating people politely, fairly, and with respect;
 - 2.8.2 on public occasions and on all society business, behaving in a way which is appropriate for a director of such an organisation. This includes not bringing the society into disrepute in any context.
- 2.9 Directors will treat meetings of the board or of any committee or sub-committee of the board as formal occasions, and will observe the following:
 - 2.9.1 accepting the authority of the chair of any meeting, expressing all questions and points of view through the chair;
 - 2.9.2 listening to the views of colleagues with an open mind, seeking advice or clarification where needed, expressing their own views, and coming to their own decision on individual matters in good faith in what they believe to be in the best interests of the society, taking into account relevant factors and ignoring irrelevant factors;
 - 2.9.3 not resorting to behaviour that could be considered to be aggressive or intimidating, e.g. swearing, name calling, shouting, finger pointing;
 - 2.9.4 keeping to the agenda, raising other issues under "any other business" according to agreed procedures, and not engaging in discussions during the meeting which are not relevant to the issues of the meeting;
 - 2.9.5 ensuring that they do not attend any meetings under the influence of alcohol, or illegal or recreational drugs.

¹⁷ The board should include in this code or in a separate resolution of the board the minimum number of attendances required each year, or the maximum number of consecutive absences, or absences per year which are permitted.

Confidentiality

- 2.10 Directors will treat all information which they receive in their capacity as directors, and all discussion within the boardroom or within committees or sub-committees of the board, as confidential.
- 2.11 Directors will observe the following obligations of confidentiality:
- 2.11.1 they will not disclose any information outside the boardroom unless it is already in the public domain, or they are specifically authorised to do so. This includes information about the society's business, the deliberations of the board in reaching decisions, and the way individual directors voted on issues;
 - 2.11.2 they will not use any such information for personal advantage;
 - 2.11.3 they will not pass information to any representative of the press or media, and will refer any press or media enquiries to the society's executives;
 - 2.11.4 they will not make unauthorised photocopies of any documents;
 - 2.11.5 they will take proper care of any documents they receive as directors, and store them securely.
- 2.12 Directors who are employees will take particular care not to disclose to their colleagues any confidential information which comes to them in their capacity as a director.

Conflicts of interest

- 2.13 Directors must disclose to the secretary any material interest which they or their spouse or partner holds in:
- 2.13.1 any business which competes with or carries on the same trade as the society;
 - 2.13.2 any business which is providing goods or services to the society, or is being considered as a potential supplier of goods and services;
 - 2.13.3 any public body or voluntary organisation with which the society has or is likely to have dealings.
- 2.14 The Secretary will record any such interest in a register of directors' interests.
- 2.15 "Material interest" for these purposes includes being an employee, holding any position of authority or responsibility, or owning any financial interest. It does not include the holding of shares which amount to less than 2% of the entire issued share capital of any company whose shares are listed on a stock exchange.
- 2.16 Subject to their society's rules, no director may take part in any discussion on a matter in which they have a material interest, or take part in any decision, or vote on any resolution. This applies to meetings of the board and of any committee or sub-committee of the board.

Taking independent advice

- 2.17 The society's management executive are responsible for running the day-to-day business of the society. If one or more directors have any questions about any aspect of the society's affairs, they should be raised in the first place with the management executive, through the secretary.
- 2.18 If the board as a whole considers that it is in the best interests of the society to do so, they may resolve to take independent advice on any matter, and shall do so through the secretary.
- 2.19 If one or more directors are dissatisfied with advice given by the management executive or the society's external advisors, or they fail to obtain their requested advice, they should raise the matter with the secretary. The secretary may take further independent advice if they consider it to be in the best interests of the society to do so. The secretary will take further independent advice if a minimum of three directors or one third of the directors (whichever is the greater) request it.
- 2.20 If the secretary is involved in the matter in question and cannot be regarded as independent for the purposes of taking further advice, another member of the management executive shall act in place of the secretary. If neither the secretary nor any member of the management executive can be regarded as independent for the purposes of the matter, it shall be referred to the Chief Executive of Co-operatives^{UK}.

Training

- 2.21 All directors shall take part in any training which the board resolves that all directors should undertake. Failure to do so without good reason is a serious breach of this Code.

Hospitality and Gifts

- 2.22 Directors should not, in their capacity as director (or what might be perceived as their capacity as director), receive from any person or organisation any hospitality, gift or any other benefit, except in the following circumstances:
- 2.22.1 working meals or refreshments;
 - 2.22.2 inexpensive items (less than £10 in value) such as free calendars;
 - 2.22.3 hospitality in the course of the society's business, which is disclosed to the secretary and recorded in a register.

Serving on the Board of a Federal Body

- 2.23 Directors who serve on the board of any federal body such as Co-operatives^{UK}, or the Co-operative Group (CWS) Limited must treat their roles as director of their society and director of any such federal body as separate.
- 2.24 This means that:
- 2.24.1 they must maintain confidentiality in relation to information they receive in one capacity, and not disclose any such information in the other capacity unless they are expressly authorised to do so;

- 2.24.2 when making decisions as a director of the society, they must make such decisions in what they consider to be the best interests of the society, and when making decisions as a director of the federal body, make them in what they consider to be the best interest of the federal body.

Breach of this Code

- 2.25 All directors accept that they must comply with this Code if the board is to be able to function properly and efficiently, and do its job. Where any director alleges that another director is in breach of this Code, the following provisions will apply:

- 2.25.1 if the allegation is made in the course of a meeting, the matter is to be referred to the chair, who may;
- 2.25.1.1 defer the matter to be considered by the board on a subsequent occasion;
 - 2.25.1.2 adjourn the meeting;
 - 2.25.1.3 request that the director alleged to be in breach temporarily leaves the meeting for the matter to be discussed by the remaining directors present;
 - 2.25.1.4 exclude the director alleged to be in breach for the remainder of the meeting;
- 2.25.2 if the remaining directors are to consider an allegation of breach of this Code at any time, the director alleged to be in breach shall be given the opportunity to respond to the allegation;
- 2.25.3 if the remaining Directors consider that a director has committed a breach of this Code,
- 2.25.3.1 the breach shall be minuted by the secretary;
 - 2.25.3.2 the board may recommend that the director in breach undergoes training;
 - 2.25.3.3 the board may resolve to report the matter to the members at the next members meeting.
- 2.25.4 subject to the rules of the society, a director in serious breach of this Code may be removed from office by a resolution approved by not less than three-quarters of the remaining directors, providing that the remaining directors also consider that it is not in the best interests of the society for that individual to continue as a director. Before any such resolution can be considered, the director alleged to be in serious breach shall be notified in writing of the alleged breach, and shall have an opportunity to answer the allegations made.

This Code of Conduct has been approved by the board of

Date:

Appendix 10

GUIDANCE ON THE ROLE OF THE CHAIR

The Higgs review identified the chair as playing a pivotal role in the company, and creating the conditions for overall board and individual professional external director effectiveness.¹⁸ Whilst accepting that the role of a chair in a co-operative society can be regarded as being different from that of a chair of a listed company there are some areas in which the role is very similar. If the board is to be encouraged to constructively challenge the management executive, then the chair must create an ambience in which directors feel supported, empowered and enabled to carry out this role. The chair should also be able to act on behalf of the board to question and monitor the management executive between board meetings and, if necessary to operate as a check on the behaviour of an inappropriately dominant chief executive.

The following guidance is based on Guidance of the Role of the Chairman as provided in Higgs Suggestions for Good Practice.¹⁹

The board shall appoint from its own number a chair and at least one deputy chair. Specifically it is the responsibility of the chair to:

- Run the board and work in conjunction with the society secretary to set its agenda. The agenda should take full account of the issues and the concerns of all board members. Agendas should be forward looking and concentrate on strategic matters rather than formulaic approvals of proposals which can be the subject of appropriate delegated powers to the management executive;
- Ensure, in consultation with the secretary, that the members of the board receive accurate, timely and clear information, in particular about the society's performance, to enable the board to take sound decisions, monitor effectively and provide advice to promote the success of the society;
- Ensure effective communication with members and ensure that the directors develop an understanding of the views of the members of the society and where they exist, the regional and/or other lower tier boards;
- Ensure that in a board meeting sufficient time is allowed for discussion of complex or contentious issues. Where appropriate the chair may need to arrange informal meetings beforehand to enable thorough preparation for the board discussion. It is particularly important that directors have sufficient time to consider critical issues and are not faced with unrealistic deadlines for decision-making;
- Work with the society secretary in providing a properly constructed induction programme for new directors that is comprehensive, formal and tailored;
- Take the lead in identifying and meeting the development needs of individual directors, with the society secretary having a key role in facilitating provision. It is the responsibility of the chair to address the development needs of the board as a

¹⁸ *The Role and Effectiveness of the Non-Executive Director*, Derek Higgs (January 2003)

¹⁹ *The Combined Code* (July 2003) Higgs Suggestions for Good Practice, p. 61-62

- whole with a view to enhancing its overall effectiveness as a team;
- Ensure that the performance of individuals and of the board as a whole and its committees is evaluated at least once a year; and
 - Encourage active involvement by all the members of the board.

The effective chair:

- Upholds the highest standards of integrity and probity;
- Sets the agenda, style and tone of board discussions to promote effective decision-making and constructive debate;
- Promotes effective relationships and open communication, both inside and outside the boardroom, between directors and the management executive team;
- Builds an effective and complementary board, initiating change and planning succession in board appointments, subject to board and members' approval;
- Promotes the highest standards of corporate governance and seeks compliance with the provisions of Co-operatives^{UK}'s Corporate Governance Code of Best Practice wherever possible;
- Ensures clear structure for and the effective running of board committees;
- Ensures effective implementation of board decisions;
- Establishes a working relationship of trust with the chief executive, providing support and advice while respecting executive responsibility; and
- Provides coherent leadership of the society, including representing the society and understanding the views of members.

The chair's term of office

The term of office of the chair should be for no longer than three years. The chair should serve for a maximum of six years before standing down. He/she will not normally be eligible for the office of chair again.

The chair should not be a current employee or recently retired superannuated employee.²⁰

Review/approval date

The chair's job description should be annually reviewed and any recommended changes should be presented to the board for ratification.

²⁰ Recently retired employees are those individuals who have been employed by the society in the past three years

Appendix 11

GUIDANCE ON THE ROLE OF THE VICE-CHAIR

It is recognised that the vice-chair also has an important role to play in facilitating the effectiveness of the board and individual directors. This Appendix outlines the responsibilities, qualifications, terms of office and selection procedures for the vice-chair of the board. It is based on accepted best practice across the movement.

Responsibilities of the Vice-Chair

The vice-chair is expected to preside at board meetings and assume other duties in the chair's absence, and in this sense, the two positions of chair and vice-chair have parallel responsibilities and skill requirements. The vice-chair may serve as chair of a board committee or take on other responsibilities at the request of the board or the chair. Skills, knowledge and experience are the primary requirements; availability, geographical balance (in a large regional society) and compatibility with the chair are other factors which may receive consideration.

Requirements:

- Commitment to the work of the organisation
- Knowledge and skills in one or more areas of board governance: policy, finance, governance and personnel
- Willingness to serve on at least one committee
- Attendance at monthly board meetings
- A time commitment of [...] ²¹ hours per month, (includes board preparation, committee and meeting time)
- Attendance at Annual General Meeting(s)
- Prepare for and participate in the discussions and the deliberations of the board
- To foster a positive working relationship with other board members, and staff
- Be aware and abstain from any conflict of interest

Major Duties:

- To act as the primary link between the chair and management executive and the actual board. The vice-chair has a key role in disseminating information about the meetings held between the chair and vice-chair and the management executive outside the normal board cycle.
- Fulfil the chair's position in the absence of the chair at monthly board meetings
- Be an active member of the board
- A signing authority on behalf of the board for financial and legal purposes
- Adhere to general duties outlined in the board member job description

²¹ This should be a decision for the individual society.

Vice-Chair Term of Office/Succession:

Vice-chair appointments should normally be made for one year and reappointments are possible. While it may be desirable for the chair designate to have vice-chair experience, this is not an absolute prerequisite for succession to the chair. Nor is vice-chair service a guarantee of appointment to the chair.

The vice-chair can be a current employee or superannuated recently retired employee.

Frequent rotation of the vice-chair position has the advantage of enlarging the board's pool of experienced members by giving more members an opportunity to serve in this capacity.

Review/Approval Date:

The vice-chair's job description should be annually reviewed and any recommended changes should be presented to the board for ratification.

Appendix 12

MODEL INDUCTION CHECKLIST

Every society should develop its own comprehensive, formal induction programme that is tailored to the needs of the society and individual directors. As a general rule a combination of selected written information together with presentations and activities such as meetings and site visits will help to give a new appointee a balanced and real-life overview of the society. Care should be taken not to overload the new director with too much information. The new director should be provided with a list of all the induction information that is being made available to them so that they may call up items if required before otherwise provided.

The following guidelines might form the core of an induction programme and are taken from the Institute of Chartered Secretaries and Administrators' UK Guidance Notes and Best Practice Guidance Notes.²²

1. The purpose of induction

1.1 To build an understanding of the nature of the society, its business and the markets in which it operates. For example, induction should cover:

- 1.1.1 The society's products or services;
- 1.1.2 Group structure/subsidiaries/joint ventures;
- 1.1.3 The society's rules, board procedures and matters reserved for the board;
- 1.1.4 Summary details of the society's principal assets, liabilities, significant contracts and major competitors;
- 1.1.5 The society's major risks and risk management strategy;
- 1.1.6 Key Commercial and Social and Co-operative Performance Indicators; and
- 1.1.7 Regulatory constraints.

1.2 To build a link with the society's people including:

- 1.2.1 Meetings with the management executive;
- 1.2.2 Visits to some society sites other than the headquarters, to learn about production or services; and
- 1.2.3 Participating in board strategy development. 'Away days' enable a new director to begin to build working relationships away from the formal setting of the boardroom.

1.3 To build an understanding of the society's main relationships including meeting the auditors and developing a knowledge of in particular:

- 1.3.1 Who are the major stakeholders;
- 1.3.2 Who are the major suppliers; and

²² <http://www.icsa.org.uk/pdfs/guidance/030214.pdf>

- 1.3.3 What is the member policy – participation in meetings with members can help give a first hand feel as well as letting members know who the directors are.

Information to be supplied to directors as part of their induction

On appointment a new director should be provided with certain key, essential information together with a comprehensive list of other information that will be subsequently made available. The following list is divided into three parts. The first includes the essential material that should be provided immediately and the second, material that should be provided over the first few weeks following the appointment, as and when deemed most appropriate. The third list covers items which the society secretary might consider making the director aware of.

2. Essential information to be provided immediately.

The following information is felt to be essential and needs to be given to the director prior to the first board meeting. Methods of delivery vary, some of the information needs to be sent to the director with his/her appointment letter; but some could be deferred until a meeting after the board papers have been issued, so that the society secretary can review the board pack with the director before the first meeting highlighting any relevant issues.

2.1 Directors' Duties

- 2.1.1 A brief outline of the role of a director and a summary of his/her responsibilities and ongoing obligations under legislation, regulation and best practice.
- 2.1.2 The society's position on:
- 2.1.2.1 Matters reserved for the board;
 - 2.1.2.2 Delegated Authorities;
 - 2.1.2.3 The policy for obtaining independent professional advice for directors;
 - 2.1.2.4 Directors' fees and the society's expenses policy and method of re-imburement.
 - 2.1.2.5 Other standing orders, policies and procedures of which the director should be aware.

2.2 The Society's Business

- 2.2.1 Current strategic/business plan, market analysis and budgets for the year with revised forecast, and three/five year plan.
- 2.2.2 Latest annual report and financial statements, and interims as appropriate.
- 2.2.3 Explanation of key commercial performance indicators.
- 2.2.4 List of major subsidiaries and joint ventures.
- 2.2.5 Summary details of major group insurance policies including director and officer liability insurance.

- 2.2.6 Details of any major litigation, either current or potential, being undertaken by the society or against the society.
- 2.3 Treasury issues:
 - 2.3.1 Funding position and arrangements;
 - 2.3.2 Dividend policy.
- 2.4 The International Co-operative Alliance's Statement of Identity and any other mission statements and reports issued by the society such as the Key Social and Co-operative Performance Indicators and corporate governance reports, with a summary of the main events (such as mergers, divestments, introductions of new products, diversification into new areas, restructuring etc.) over the last three years.
- 2.5 Board Issues
 - 2.5.1 Up to date copy of the society's rules.
 - 2.5.2 Minutes of the last 3 to 6 board meetings.
 - 2.5.3 Schedule of dates and times of future board meetings and board committees if appropriate.
 - 2.5.4 Description of board procedures covering details such as when papers are sent out, the normal location of meetings, how long they last and an indication of the routine business transacted.
 - 2.5.5 Brief biographical and contact details of all directors of the society, the society secretary and other key executives. This should include their dates of appointment and any board committees upon which individual directors sit.
 - 2.5.6 Details of board committees together with terms of reference and, if the director will be joining a committee, copies of the minutes of meetings of that committee during the previous 12 months.

3. Additional material to be provided during the first few months.

The following information is crucial to assist the director to develop his/her knowledge of the society, its operations and staff, but is not necessary for him/her to commence his/her involvement. It is suggested, however, that a detailed schedule of the information available is provided to him/her, and the information is supplied either on request or within three months of appointment. It would also be appropriate to members of the management executive in the induction programme so that the director begins to get a view of the depth of management available. This could include:

- 3.1 Copies of recent press cuttings, reports and articles concerning the society.
- 3.2 Details of the society's advisers (lawyers, bankers, auditors, registrars etc.), both internal and external, with the name of the partner dealing with the society's affairs.
- 3.3 The society's risk management procedures and relevant disaster recovery plans.
- 3.4 Details of the society's corporate governance guidelines and Co-operatives^{UK}'s Corporate Governance Code of Best Practice which the society seeks to follow.
- 3.5 A brief history of the society including any major mergers and other significant events during its history.

- 3.6 Notices of any general meetings held in the last 3 years, and accompanying circulars as appropriate.
- 3.7 The society's organisation chart and management succession plans.
- 3.8 A copy of all management accounts prepared since the society's last audited accounts.
- 3.9 The society's member policy and details of any other investors.
- 3.10 Details of the five largest suppliers to the society, including CRTG.
- 3.11 Policies as regards:
 - 3.11.1 Health & Safety;
 - 3.11.2 Environmental;
 - 3.11.3 Ethics and Whistle-blowing;
 - 3.11.4 Tendering
- 3.12 Charitable, co-operative and political donations.
- 3.13 Internal society telephone directory

4. Additional information which the society secretary might consider making the director aware of

The final section includes information which will differ for all societies and the secretary will need to use his/her experience and knowledge to pass on information to allow the director to feel accustomed to the business as soon as possible.

- 4.1 Protocol, procedures and dress code for:
 - 4.1.1 Board meetings;
 - 4.1.2 General meetings;
 - 4.1.3 Formal dinners, staff social events, site visits etc.
- 4.2 Procedures for:
 - 4.2.1 Financial statements sign off;
 - 4.2.2 Trading results announcements;
 - 4.2.3 Items requiring approval outside of scheduled board meetings.

Appendix 13

TERMS OF REFERENCE – THE REMUNERATION COMMITTEE

The Combined Code on Corporate Governance (the Combined Code) states that:

“There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors.”²³

In co-operative societies directors do not receive a remuneration package as such, but their fee levels still need to be determined by a committee, which can then take this recommendation to the board and then the members for their approval. The other objective of the remuneration committee is to ensure that the society goes through a formal process of considering management executive remuneration. As with most aspects of corporate governance a society must be seen to be doing this in a fair and thorough manner. It is therefore essential that the remuneration committee is properly constituted with a clear remit and identified authority. This appendix is based on the Institute of Chartered Secretaries and Administrators UK Guidance Notes and Best Practice Guidance Notes.²⁴

1. Membership

- 1.1. Members of the committee shall be appointed by and from the board. The committee shall be made up of at least [3] members. No directors who are also employees of the society should be allowed to sit on this committee.
- 1.2. Only members of the remuneration committee, and the secretary (or the person nominated to service the committee), have the right to attend remuneration committee meetings. However, other individuals such as the chief executive, the head of human resources, the chief finance officer and external advisers may be invited to attend for all or part of any meeting as and when appropriate.
- 1.3. Appointments to the committee shall be for a period of up to three years, which may be extended for two further three-year periods.
- 1.4. The board shall appoint the committee chair. In the absence of the committee chair and/or an appointed deputy, the remaining members present shall elect one of themselves to chair the meeting.

2. Secretary

- 2.1 The society secretary, or their nominee, shall act as the secretary of the committee.

²³ *The Combined Code on Corporate Governance* July 2003, B.2

²⁴ <http://www.icsa.org.uk/pdfs/guidance/031022.pdf>

3. Quorum

- 3.1 The quorum necessary for the transaction of business shall be [2]. A duly convened meeting of the committee at which a quorum is present shall be competent to exercise all or any of the authorities, powers and discretions vested in or exercisable by the committee.

4. Meetings

- 4.1 The committee shall meet [*at least once a year*] and at such other times as the chair of the committee shall require²⁵.

5. Notice of Meetings

- 5.1 Meetings of the committee shall be summoned by the secretary of the committee at the request of any of its members.
- 5.2 Unless otherwise agreed, notice of each meeting confirming the venue, time and date together with an agenda of items to be discussed, shall be forwarded to each member of the committee, any other person required to attend and all other directors, no later than one week before the date of the meeting. Supporting papers shall be sent to committee members and to other attendees as appropriate, at the same time.

6. Minutes of Meetings

- 6.1 The secretary shall minute the proceedings and resolutions of all committee meetings, including the names of those in attendance.
- 6.2 Minutes of committee meetings shall be circulated promptly to all members of the committee and, once agreed, to all members of the board, unless a conflict of interest exists.

7. The Annual General Meeting

- 7.1 The chair of the committee, or a nominated deputy, shall attend the Annual General Meeting²⁶ and be prepared to respond to any member questions on the committee's activities.

²⁵ The frequency and timing of meetings will differ according to the needs of the society. Meetings should be organised so that attendance is maximised (for example by timetabling them to coincide with board meetings).

²⁶ Where a society helpfully holds an AGM over a number of locations, the chairs of board committees, or their nominated deputies, should attend at least the final meeting.

8. Duties

The committee shall:

- 8.1 Determine and agree with the board the framework or broad policy for the remuneration of the society's chief executive, the society secretary and such other members of the management executive as it is designated to consider.
- 8.2 Make recommendations to take to the board with regard to the remuneration of co-opted professional external directors and the fees of elected directors. No director or manager shall be involved in any decisions as to their own remuneration;
- 8.3 In determining such policy, take into account all factors which it deems necessary. The objective of such policy shall be to ensure that members of the management executive of the society are provided with appropriate incentives to encourage enhanced performance and are, in a fair and responsible manner, rewarded for their individual contributions to the success of the society;
- 8.4 Review the ongoing appropriateness and relevance of the remuneration policy and ensure that remuneration and incentive packages for senior employees are related to relevant profit or trading surpluses and not simply to turnover;
- 8.5 Approve the design of, and determine targets for, any performance related pay schemes operated by the society and approve the total annual payments made under such schemes;
- 8.6 Receive, review and decide on issues raised by the society's Pension Fund and any retirement benefit scheme within the organisation and advise the board of them as appropriate;
- 8.7 Ensure that contractual terms on termination, and any payments made, are fair to the individual, and the society, that failure is not rewarded and that the duty to mitigate loss is fully recognised;
- 8.8 Within the terms of the agreed policy and in consultation with the chief executive as appropriate, determine the total individual remuneration package of each executive including bonuses and incentive payments;
- 8.9 In determining such packages and arrangements, give due regard to any relevant legal requirements;
- 8.10 Review and note annually the remuneration trends across the society or group;
- 8.11 Oversee any significant changes in employee benefits structures throughout the society or group;
- 8.12 Agree the policy for authorising claims for expenses from the chief executive;
- 8.13 Be exclusively responsible for establishing the selection criteria, selecting, appointing and setting the terms of reference for any remuneration consultants who advise the committee and to obtain reliable, up-to-date information about remuneration in other societies and comparative businesses. The committee shall have full authority to commission any reports or surveys which it deems necessary to help it fulfil its obligations.

9. Reporting Responsibilities

- 9.1 The committee chair shall report formally to the board on its proceedings after each meeting on all matters within its duties and responsibilities.
- 9.2 The committee shall make whatever recommendations to the board it deems appropriate on any area within its remit where action or improvement is needed.

9.3 The committee shall produce an annual report of the society's remuneration policy and practices which will form part of the society's annual report and ensure each year that it is put to members for approval at the AGM.

10. Other

10.1 The board shall, at least once a year, review the performance of the remuneration committee, constitution and terms of reference to ensure it is operating at maximum effectiveness.

10.2 Authority

11.1 The committee is authorised by the board to seek any information it requires from any employee of the society, via the secretary, in order to perform its duties.

11.2 In connection with its duties the committee is authorised by the board to obtain, at the society's expense, any outside legal or other professional advice.

Appendix 14

TERMS OF REFERENCE – THE AUDIT COMMITTEE

The Combined Code on Corporate Governance (the Combined Code) states that:

"The board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors"²⁷.

The audit committee has become an increasingly important tool of good governance and it is important that all co-operative societies have an established and competent audit committee in place.

The guidance on audit committees (The Smith Report) recognises that "audit committee arrangements need to be proportionate to the task, and will vary according to the size, complexity and risk profile of the company"²⁸.

As with most aspects of corporate governance, the above principle make it clear that, not only should societies go through a formal process of considering their internal audit and control procedures and evaluating their relationship with their external auditor, but they must be seen to be doing so in a fair and thorough manner. It is, therefore, essential that the audit committee is properly constituted with a clear remit and identified authority. The following appendix is taken from the Institute of Chartered Secretaries and Administrators UK Guidance Notes and Best Practice Guidance Notes.²⁹

1. Membership

- 1.1. The board shall appoint members of the committee, preferably on the recommendation of the search committee (where one exists). The committee shall be made up of at least [3] members and no more than seven.
- 1.2. At least one member shall have recent and relevant financial experience and preferably a formal accountancy qualification.
- 1.3. The chief executive and the chair shall not be members. No employee director, spouse of an employee, recently retired employee or supplier to the society shall serve on the audit committee.
- 1.4. Only members of the committee, and the secretary (or the person nominated to service the committee), have the right to attend committee meetings. However, other individuals such as the chair of the board, chief executive, chief finance officer, other directors, the heads of risk, compliance and internal audit and representatives from the finance function may be invited to attend all or part of any meeting as and when required for specific purposes.
- 1.5. The external auditors will be invited to attend meetings of the committee on a regular basis.

²⁷ *The Combined Code on Corporate Governance* July 2003, C.3.

²⁸ *Audit Committees - Combined Code Guidance* January 2003

²⁹ <http://www.icsa.org.uk/pdfs/guidance/031020.pdf>

- 1.6. Appointments to the committee shall be for a period of up to three years, which may be extended for two further three-year periods.
- 1.7. The board shall appoint the committee chair who shall be, where one exists, a co-opted professional external director. In the absence of the committee chair and/or an appointed deputy, the remaining members present shall elect one of themselves to chair the meeting.

2. Secretary

- 2.1. The secretary or their nominee shall act as the secretary of the committee.
- 2.2. The secretary should ensure that members of the audit committee are provided with sufficient training, this should include:
 - 2.2.1 An induction programme for new audit committee members. This should cover the role of the audit committee, including its terms of reference and expected time commitment by members; and an overview of the society's business, identifying the main business and financial dynamics and risks.
 - 2.2.2 Ongoing and timely training which should include an understanding of:
 - 2.2.2.3 The principles of, and developments in, financial reporting;
 - 2.2.2.4 Industrial and Provident society law relating to the legal structure of the society;
 - 2.2.2.5 Understanding financial statements;
 - 2.2.2.6 Applicable accounting standards and recommended practice;
 - 2.2.2.7 The role of internal and external auditing; and
 - 2.2.2.8 Risk management.

3. Quorum

- 3.1. The quorum necessary for the transaction of business shall be [2] members. A duly convened meeting of the committee at which a quorum is present shall be competent to exercise all or any of the authorities, powers and discretions vested in or exercisable by the committee.

4. Frequency of Meetings

- 4.1. The committee shall meet [*at least three times a year at appropriate times in the reporting and audit cycle*] and otherwise as required³⁰.

5. Notice of Meetings

- 5.1. Meetings of the committee shall be summoned by the secretary of the committee at the request of any of its members or at the request of external or internal auditors if they consider it necessary.

³⁰ The frequency and timing of meetings will differ according to the needs of the society. Meetings should be organised so that attendance is maximised (for example by timetabling them to coincide with board meetings).

- 5.2. Unless otherwise agreed, notice of each meeting confirming the venue, time and date together with an agenda of items to be discussed, shall be forwarded to each member of the committee, any other person required to attend and all other directors, no later than one week before the date of the meeting. Supporting papers shall be sent to committee members and to other attendees as appropriate, at the same time.

6. Minutes of Meetings

- 6.1. The secretary shall minute the proceedings and resolutions of all meetings of the committee, including recording the names of in attendance.
- 6.2. The secretary shall ascertain, at the beginning of each meeting, the existence of any conflicts of interest and minute them accordingly.
- 6.3. Minutes of committee meetings shall be circulated promptly to all members of the committee and, once agreed, to all members of the board.

7. Annual General Meeting

- 7.1. The chair of the committee, or a nominated deputy, shall attend the Annual General Meeting³¹ and be prepared to respond to any member questions on the committee's activities.

8. Duties

The committee should carry out the duties below, for the society and any subsidiaries it may have.

- 8.1. Financial Reporting
- 8.1.1 The committee shall monitor the integrity of the financial statements of the society, including its annual and interim reports.
- 8.1.2 The committee shall review and challenge where necessary:
- 8.1.2.1 The consistency of, and any changes to, accounting policies both on a year on year basis and across the society/group;
 - 8.1.2.2 The methods used to account for significant or unusual transactions where different approaches are possible;
 - 8.1.2.3 Whether the society has followed appropriate accounting standards and made appropriate estimates and judgements, taking into account the views of the external auditor;
 - 8.1.2.4 The clarity of disclosure in the society's financial reports and the context in which statements are made; and
 - 8.1.2.5 All material information presented with the financial statements, such as the operating and financial review and the corporate governance statement (insofar as it relates to the audit and risk management).

³¹ Where a society helpfully holds an AGM over a number of locations, the chairs of board committees, or their nominated deputies, should attend at least the final meeting..

8.1.3 The committee shall review the annual financial statements of the pension funds where not reviewed by the board as a whole.

8.2 Internal controls and risk management systems. The committee shall:

8.2.1 Keep under review the effectiveness of the society's internal controls and risk management systems; and

8.2.2 Review and approve the statements to be included in the annual report concerning internal controls and risk management ³².

8.3 Whistle-blowing

The committee shall review the society's arrangements for its employees to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters. The committee shall ensure that these arrangements allow proportionate and independent investigation of such matters and appropriate follow up action.

8.4 Internal Audit

The committee shall:

8.4.1 Monitor and review the effectiveness of the society's internal audit function, or outsourced provider of Internal audit, in the context of the society's overall risk management system³³;

8.4.2 Approve the appointment and removal of the head of the internal audit function;

8.4.3 Consider and approve the remit of the internal audit function and ensure it has adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards. The committee shall also ensure the function has adequate standing and is free from management or other restrictions which may impair the independence of internal audit

8.4.4 Review and assess the annual internal audit plan;

8.4.5 Review promptly all reports on the society from the internal auditors;

8.4.6 Review and monitor management's responsiveness to the findings and recommendations of the internal auditor; and

8.4.7 Meet the head of internal audit at least once a year, without management being present, to discuss their remit and any issues arising from the internal audits carried out. In addition, the head of internal audit shall be given the right of direct access to the chair of the board and to the committee.

8.5 External Audit

The committee shall:

³² Unless this is done by the board as a whole.

³³ If the society does not have an internal audit function, the committee should consider annually whether there should be one and make recommendations to the board accordingly. The absence of such a function should be explained in the annual report.

- 8.5.1 Consider and make recommendations to the board, to be put to members for approval at the AGM, in relation to the appointment, re-appointment and removal of the society's external auditor. The committee shall oversee the selection process for new auditors and if an auditor resigns the committee shall investigate the issues leading to this and decide whether any action is required;
- 8.5.2 Oversee the relationship with the external auditor including (but not limited to):
 - 8.5.2.1 Approval of their remuneration, whether fees for audit or non-audit services and that the level of fees is appropriate to enable an adequate audit to be conducted;
 - 8.5.2.2 Approval of their terms of engagement, including any engagement letter issued at the start of each audit and the scope of the audit;
 - 8.5.2.3 Assessing annually their independence and objectivity taking into account relevant [UK] professional and regulatory requirements and the relationship with the auditor as a whole, including the provision of any non audit services;
 - 8.5.2.4 Satisfying itself that there are no relationships (such as family, employment, investment, financial or business) between the auditor and the company (other than in the ordinary course of business);
 - 8.5.2.5 Agreeing with the board a policy on the employment of former employees of the society's auditor, then monitoring the implementation of this policy;
 - 8.5.2.6 Monitoring the auditor's compliance with relevant ethical and professional guidance on the rotation of audit partners, the level of fees paid by the society compared to the overall fee income of the firm, office and partner and other related requirements; and
 - 8.5.2.7 Assessing annually their qualifications, expertise and resources and the effectiveness of the audit process which shall include a report from the external auditor on their own internal quality procedures.
- 8.5.3 Meet regularly with the external auditor, including once at the planning stage before the audit and once after the audit at the reporting stage. The committee shall meet the external auditor at least once a year, without management being present, to discuss their remit and any issues arising from the audit;
- 8.5.4 Review and approve the annual audit plan and ensure that it is consistent with the scope of the audit engagement;
- 8.5.5 Review the findings of the audit with the external auditor. This shall include but not be limited to, the following:
 - 8.5.5.1 A discussion of any major issues which arose during the audit,
 - 8.5.5.2 Any accounting and audit judgements, and
 - 8.5.5.3 Levels of errors identified during the audit.

The committee shall also review the effectiveness of the audit.

- 8.5.6 Review any representation letter(s) requested by the external auditor before they are signed by management;
- 8.5.7 Review the management letter and management's response to the auditor's findings and recommendations; and
- 8.5.8 Develop and implement a policy on the supply of non-audit services by the external auditor, taking into account any relevant ethical guidance on the matter.

8.6 Reporting Responsibilities

- 8.6.1 The committee chair shall report formally to the board on its proceedings after each meeting on all matters within its duties and responsibilities.
- 8.6.2 The committee shall make whatever recommendations to the board it deems appropriate on any area within its remit where action or improvement is needed.
- 8.6.3 The committee shall compile a report to members on its activities to be included in the society's annual report.

8.7 Other Matters

The committee shall:

- 8.7.1 Have access to sufficient resources in order to carry out its duties, including access to the society secretariat for assistance as required;
- 8.7.2 Be provided with appropriate and timely training, both in the form of an induction programme for new members and on an ongoing basis for all members;
- 8.7.3 Give due consideration to Co-operatives^{UK}'s Corporate Governance Code of Best Practice and the provisions of the Combined Code;
- 8.7.4 Be responsible for co-ordination of the internal and external auditors;
- 8.7.5 Oversee any investigation of activities which are within its terms of reference and act as a court of the last resort; and
- 8.7.6 The board shall, at least once a year, review the performance of the Audit committee, constitution and terms of reference to ensure it is operating at maximum effectiveness.

9. Authority

The committee is authorised:

- 9.1 To seek any information it requires from any employee of the society, via the secretary, in order to perform its duties;
- 9.2 To obtain, at the society's expense, outside legal or other professional advice on any matter within its terms of reference; and
- 9.3 To call any employee to be questioned at a meeting of the committee as and when required.

Appendix 15

WHISTLE-BLOWING

The Financial Services Authority (FSA) has suggested that firms should have internal procedures for dealing constructively with information provided by whistle-blowers, backed by an external system for cases where internal procedures do not exist or are inadequate. ICSA's Best Practice Guide on Whistle-blowing recommends that employees' representatives should be involved in establishing the procedure and monitoring its implementation.

Listed below are some key pointers for establishing a whistle-blowing procedure within the society.

- The internal whistle-blowing procedures should be documented and a copy should be given to every employee.
- It should set out the key aspects of the procedures, such as the person to whom employees should report their suspicions or concerns (e.g. the secretary).
- It should contain a statement that the employer takes malpractice or misconduct seriously, and is committed to a culture of openness in which employees can report legitimate concerns without fear of penalty or punishment.
- It should give examples of the type of misconduct for which employees should use the procedure and set out the level of proof that there should be in an allegation. (Although positive proof may not be required, a whistleblower should be able to provide good reasons for his or her concern.)
- It should make clear that false or malicious allegations would result in disciplinary action against the individual making them but that no action will be taken if the allegation is made honestly and in good faith.
- An external whistle-blowing route should be offered, as well as an internal whistle-blowing procedure.
- The document should set out properly by which an allegation will be investigated.

Please see the following link for the Public Interest Disclosure Act 1998 in full

<http://www.legislation.hmso.gov.uk/acts/acts1998/19980023.htm>