A personal perspective by SHEILA KHAMA

GOOD CORPORATE GOVERNANCE BLOG SERIES

BOARDS OF PARTNERSHIPS AND STATE-OWNED ENTITIES IN MINERALS, OIL AND GAS INDUSTRIES

Blog 6

Strengthening Corporate Governance – Role of Board Committees

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1. Introduction

In a previous blog, I shared my perspective on challenges of corporate governance facing boards of State Owned Enterprises (SOEs) and partnerships between the State and private investors. As with many corporate and public policy governance challenges, there is rarely a perfect much less single solution to problems facing boards. But boards of these and other types of companies can benefit from tried and tested methods to increase effectiveness. One of these is the creation of sub-committees of the board responsible for specific strategic, operational and compliance matters. In this blog, I discuss the role of such committees in strengthening corporate governance through board effectiveness as relates to the SOEs and partnership between investors and the State in minerals, oil and gas companies.

2. About Boards Committees

The purpose, structure and composition of committees vary from company to company because committees are designed and their members selected to ensure that they are fit for purpose. Therefore, boards must make informed choices on what works for their companies based on strategic, operational and compliance considerations. Other considerations are their legal standing such as whether a committee is a statutory, a standing, adhoc or other type. An important aspect of the decision is the very mandate and authority of each committee. The latter is essential because among others, it determines whether a committee has decision making powers or if it may only recommend to the board as discuss below.

2.1

Why Board Committees

A good place to start in discussing the role of committees is to define the term committee in the first place. One source defines it as, '*a group of people appointed for a specific function by a larger group.'* [1] From this one deduces a number of factors. Firstly, that a committee is an offshoot of a larger group with collective responsibility. Secondly that it has delegated duties assigned by the group. Lastly that it exists for a specific purpose. Consistent with this definition board committees are selected from the board membership to be responsible for performing a specific role on behalf of (but not as a substitute to) the board that retains overall accountability. The goal is to deploy specialist skills of directors necessary to perform specific functions of the board with greater competency and scrutiny than is possible collectively.

1. *https://languages.oup.com/google-dictionary-en/*

A noteworthy point is the presumption of competency on the part of directors in the first place. It is for this reason that the tendency by some governments to appoint loyalists to SOE boards can be self-defeating because under such circumstances, lack of skills undermines the potential value-add by members. Such boards are unable to benefit from the creation of committees because to borrow a scientific phrase, the pool gene is deficient.

2.2

Types of Board Committees

There are several ways of differentiating committees and the **three factors that are most common are:**

The first type is in response to regulatory requirements calling for creation of a specific committee to perform legally stipulated roles based on the laws that govern the industry while others are created in line with the company's constitution. Some in this category are a permanent feature of the corporate structure and work streams of the board, while others are created on an ad-hoc basis for a specific purpose and duration. *(My **Blog 5** of types of company legal structures provides context)*. The second differentiator is the purpose for which a committee is created. This can be to either perform an oversight role, review complex issues and recommend to the board, or make decisions on behalf of the board based on an approved threshold. A final factor is composition based on whether membership comprises non-executive or executive directors. In case of the latter, the scope of the committee's work is confined to operational matters. Within this broad range, a committee may also be called to advise the board on particular areas of the business. Oversight duties include project management. While recommendations include investments and policy leading to board approval if deemed appropriate. The last two are commonly assigned to the executive committee while statutory ones are left to non-executive directors to avoid bias on the part of the executive team and to strengthen oversight based on the governance principle of the avoidance of conflicting interests.

2.3

Composition of Board Committees

To increase board effectiveness the composition, nominations, and membership of board committees must align to the function of the committee. On the other hand committee members must have diverse skills and experiences. Members of committees can be chosen by the chair of a board or by the entire board. On the other hand, some committees require membership of an independent director who might also have to chair some committees. An independent director is defined as, *'a board member who is not part of the company's executive management team and therefore independent from the company's management and shareholders, with no material ties to the company'.* [2] There are many other considerations including the specific role of the chairperson of the board as well as the chairs of remuneration and audit committees. However, regardless of the type of committee, it is crucial to include individuals well-versed in as many of the aspects of the business, accounting, law, sustainability, and marketing principles and practices as possible.

2.4

Capacitating Committees

Effective boards do not leave much to chance. Mindful that even with the best endeavors, it is impossible for any board of directors to possess all the skills necessary to competently address any eventuality, responsible boards take additional measures to capacitate themselves and committees. The objective is to contain the risk of decisions that could impact the company adversely. Therefore, company boards set aside financial resources to engage advisors or undergo training, as a matter of course. The resources are available to the collective, to individual directors and to committees. Typical areas of training and advice are legislative amendments, emerging governance trends, emerging industry risk, major market developments, as well as legal and financial advice on complex once-off transactions. Boards tap the knowledge of academia, think-tanks, market and financial analysts to continuous apprise themselves of sources of risk and opportunities. Though costly boards incur the cost based on the understanding that not capacitating themselves adequately could lead to some potentially greater cost to the company and a liability to themselves.

2. https://corporatefinanceinstitute.com/resources/career/independent-director/

3. Types of Committees & Contribution to Board Effectiveness

Whatever their purpose, composition or capacity, committees are inextricably linked to board effectiveness in all types of companies including boards of partnerships and SOEs. The committees can potentially improve corporate governance and based on the concept of responsible stewardship as discussed in my **Blog 1** of the series, in minerals, oil and gas industries, four types of committees are particularly important. The four committees are sustainability, risk, audit, as well as nomination and governance committees. The four contribute directly to sustainable development of non-renewable wealth and are discussed briefly under paragraph 3.1 to 3.4 below.

3.1

Sustainability Committee

A sustainability committee of the board oversees development and implementation of a sustainable business strategy. Its mandate is to ensure that in the long run, environmentally, socially and economically company operations have a net positive impact. This is in keeping with the concept of a triple bottom line and sustainable development principles. The need for such a committee stems largely from the recognition that unless the correct mitigants are put in place, minerals, oil and gas operations can have adverse impacts on the physical and social environments and well as on national economies. Economic impacts relate to challenges of the resources curse as discussed in **Blog 2**. In this regard, SOEs and partnerships with the State have a direct role in fostering economic development and committees that manage the risk of unintended economic consequences are their logical safeguards. This also aligns to demands by host countries, regulators and other stakeholders that companies put measures in place to minimize negative impacts on society. But not only do companies face these demands, but to comply with legal requirements, companies must meet several performance and reporting standards on a range of performance indicators. Wherein many standards in the environmental, employee rights, health and safety areas have been in practice for decades in these industries, the difference is that some were voluntary. The most common sources of guidelines and performance assessment being the *International Standard Organization* (ISO)[3] Certifications and *International Labour Standards on Occupational Safety and Health Administration* (OSHA)[4]. However, increasingly aspects of the standards have become a legal requirement by governments and stock markets like the *New York Stock Exchange* in relation to environmental, social and governance (ESG) reporting. This has also led to an emergence of standards and independent agencies for rating.

3. https://www.iso.org/home.html
4. https://www.ilo.org/

For their part, financiers and shareholders respond out of enlightened self-interest based on the knowledge that failure to comply places their investment at financial, reputational and legal risk. This explains the wide range of issues under the committee's remit including human rights, the supply chain, biodiversity, safety, ethics and carbon footprint reduction, energy efficiency and waste reduction as illustrated under **Diagram 1** below. As a result, sustainability strategies promote the use of renewable energy resources to ensure that all initiatives align with the quest for net zero. Therefore, through this committee, companies invest resources to strategize and oversee a hierarchy of activities starting with development, implementing and evaluation of sustainability policies that align with regulatory requirements and organizational goals. The aim is to manage risk by identifying and assessing ESG risks and recommending mitigation strategies to the board. Through pre-set KPIs in a company's operations, the committee monitors sustainability performance using periodic audits.

An important part of the remit of the committee is to ensure effective stakeholder engagement internally and externally. This gauges the company's sustainability performance and demonstrates transparency. In industries that need a social license to operate, the work of sustainability committees is part and parcel of a company's survival strategy. The novel but diverse nature of some of the issues in the remit of the committee means that the committee frequently relies on routine expert advice to understand new scientific and policy concepts as well as keep track of changing trends. As such it is a costly but essential role that most companies can ill afford to ignore. Some SOEs buck the trend because for political reasons they are often shielded from public scrutiny and given a pass. For their part boards of such companies, therefore, fail the test of good governance based on fiduciary responsibility. Sadly, the cost to society is still the same. In case of companies with robust sustainability strategies, the value proposition to stakeholders and brand positioning can be strong. Nevertheless, the matrix below illustrates the extensive and intricate work of sustainability committees and the executives they oversee.

Diagram 1
Sustainability Matrix

Source: ResearchGate [5]

		HUMAN WELL-BEING				AGGREGATE DEMANDS
		ECOLOGICAL Preservation	ECONOMIC Efficiency	SOCIAL Equity	INSTITUTIONAL Management Capacity	
DEMANDS POSED ON THE DIFFERENT DIMENSIONS	ECOLOGICAL	Water, Soil, Air, Biodiversity.	Access (to resources for production)	Access (to resources for life)	Current state of affairs & new scenarios (of environmental resources).	ECOSYSTEM SERVICES
	ECONOMIC	Eco-friendly practices. Low-impact production. Product life-cycle.	Productivity. Independence from external supplies. Competitiveness.	Livelihoods. Corporate social responsibility. Social mobility.	Corporate training. Regulatory compliance. Participation.	ECONOMIC RESOURCES
	SOCIAL	Awareness & awareness raising about environmental issues. Responsible use of environmental resources.	Instruction. Labour.	Cultural capital. Human capital. Social capital.	Social organisation.	SOCIAL PARTICIPATION
	INSTITUTIONAL	Legislation. Participation of social capital. Education for sustainability.	Legislation. Organisation of social capital services.	Access. Citizenship. Participation.	Legislation. Enforcement. Oversight.	ADAPTIVE MANAGEMENT
CONTRIBUTIONS TO HUMAN WELL-BEING		HEALTHY & PRODUCTIVE ENVIRONMENT	ECONOMIC PROGRESS	PROSPERITY & EQUITABLE SOCIAL OPPORTUNITIES	PARTICIPATORY GOVERNANCE	DIRECTION OF THE SYSTEM IN TERMS OF SUSTAINABILITY

5. https://www.researchgate.net/figure/Sustainability-Matrix-for-a-Production-System_fig11_329221611

3.2 *Risk Committee*

Investors accept that in investing resources into a company, by its very nature, this act introduces some degree of risk. However, in doing so and through a series of systematic processes that vary in degree of effort, investors weigh the risk identified relative to expected rewards to ensure that the latter outweighs the former. Therefore, from the onset, companies put significant resources into ensuring that boards and management are sighted of material risk. Equally essential is the board's ability to assess the likelihood of a risk occurring. Another important action is an assessment of the material impacts of such an occurrence on the company in the event the risk manifests.

Diagram 2 shows a more comprehensive cycle of planning, implementation and monitoring guidelines for risk oversight. This process is the essence of responsibility of a risk committee which contributes to the work of the board by overseeing the company's risk strategy and putting in place a risk management framework to guard against major losses. The function can also be integrated into the work of an audit committee. Where the two are separate, the two committees work closely on corporate governance, compliance and operational risk matters. The goal is to identify, assess and mitigate material risk based on a preset threshold that is guided by a conscious level of corporate risk appetite.

Diagram 2
Five Steps of the Risk Management Process 2025

Source: 360 Factors 6

6. https://www.360factors.com/blog/five-steps-of-risk-management-process/

In most corporate settings the risks in the committee's remit are mainly operational and reputational. However, based on two factors in case of minerals, oil and gas industries and notwithstanding the importance of the operational and reputational risk, there are some additional very important industry specific sources of potential risk. The first factor is the long term nature of financial commitments made by companies in developing and operating projects based on the immovable nature of the primary assets. The second factor is the advent of sovereign risk. The definition of sovereign risk has traditionally been confined to failure by a country to pay national debt. But it is increasingly been expanded to include *'the consequences for business profits of a change in taxes, subsidies or regulations.'* [7] The risk manifest in different ways ranging from regulatory instability, foreign exchange controls, international trade sanctions, resources nationalism and lack of security of tenure over resources licenses. Another common source of risk to industries is what is known as social risk. Social risk has been defined *'as the exposure to adverse consequences stemming from population-based activities and negative public perception.'* [8] Primarily because the risks in this paragraph emanate from the actions of State institutions, while they impact private investors, they very rarely affect SOEs. Which suggests that SOEs operate in a potentially more stable environment, yet their performance in many countries in emerging markets suggests that this does not correlate to this position of advantage.

Given the age of **Artificial Intelligence (AI)**, remote working and the proliferation of online internal and external platforms, and the threat that comes with IT installations, has given prominence to cyber risk. Though a permanent feature of risk strategy of modern day risk committees, most companies integrate it into the broader risk. Nevertheless, in the industries in question, it is a major source of concern based on the potential disruption that this risk would cause to many systems including human resources, finance, and engineering installations.

3.3

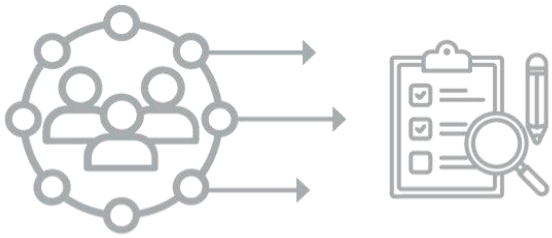
Audit Committee

An audit committee is a committee of a board responsible for supervising company systems and processes of financial reporting, internal controls, financial risk management and auditing. As such the committee is one of the essential platforms of an organization's operations and a major element of company corporate governance mechanisms. But audit committees do not only protect the company and its shareholders but protect all those with a vested interest in the ongoing health of the organizations otherwise known as proof of *'going concern'.* The going concern principle is one of the fundamental principles of accounting. It asserts that at the time of pronouncement, there is proof that, *'the entity will continue to remain in business for the foreseeable future. Conversely, it also means that the entity does not plan to, or expect to be forced to, liquidate its assets'*.[9]

7. https://theconversation.com/what-is-and-isnt-a-sovereign-risk-30612
8. https://www.rmmagazine.com/articles/article/2021/04/01/-Understanding-and-Mitigating-Social-Risk-
9. https://corporatefinanceinstitute.com/resources/accounting/going-concern/

This pronouncement follows an external auditor's review of a company's financials and is vital because it gives credible assurance of the ability of the company to not only carry out its business but to engage in business with others in good faith and without false pretext. This includes business conducted with suppliers, service providers, employees, stock markets, financiers and the regulator. It is a major tool for protecting the public which in the case of minerals, oil and gas companies includes the receiver of revenue, communities reliant on the company for jobs, donations and business opportunities. An important qualifier is that this statement of going concern must be reaffirmed on an annual basis though a company might also carry out an assessment at interim stages in the year.

To achieve this, members of this committee must ensure that the necessary internal controls are in place and oversee the internal auditor's work independent of management. The committee must ensure accurate and transparent financial reporting as well as proper disclosure in financial statements. They must also verify the company's compliance with the prevailing reporting and auditing standards, laws and regulations as relates to these matters. To strengthen oversight and independence from those responsible for producing financial reports, most audit committees comprise only of external (non-executive) board members, with an independent director as the chair of the committee and at least one member with experience in the fields of finance and accounting. A primary requirement for effectiveness is that its members have unfettered access to information, internal and external auditors. This way, the committee becomes a vital source of third-party assurance to stakeholders who are not in a position to validate reports by the companies.



Effective audit committees identify opaque transactions and propose ways to improve reporting in addition to its conventional mandate.

Thus an audit committee can ensure transparency and improve accountability of SOEs. In case of partnerships between the State and multinationals, and by working hand in hand with resource auditors, the committee can provide assurance on the legitimacy intercompany pricing and payment systems. In case of SOEs the committee can scrutinize inflated public contracts and save the public from project overpricing to reward party loyalists at the expense of national interests. However, a limitation of the role of all audit committees is that they function well in an environment of professionalism and business ethics on the part of the executives and auditors upon whom they rely for information. This is common but not guaranteed. On the other hand while able to increase transparency especially in case of partnerships that use international reporting standards, much of the information and formatting in company financial reports is incomprehensible to the average person including political representatives.

3.4

Nomination and Governance Committee

A nomination and governance committee is established to assess and improve corporate governance exercised by the board of directors. It is also responsible for determining the skills and characteristics necessary to serve on the board and the executive.

It often includes the chair, deputy chair and the CEO. As previously noted, SOEs boards are vulnerable to cronyism. Therefore, a transparent and objective framework for selecting members and facilitating succession plans reduces this risk. Succession planning is particularly important in case of representatives of governments on SOEs and partnerships. This not only ensures preparedness, but it reduces political interference. Hence, a systematic oversight process of the nomination and succession planning frameworks is often a major responsibility of the chairperson of the board who also chairs this committee.

In minerals, oil and gas companies that are often major employers in emerging markets, by collaborating with the State, the committee can champion human capital development and transfer of skills from multinationals to citizens in the top hierarchy. It can be a major contributor towards the capacity of partnerships and SOEs to transit from third party project operators to owner operators. By achieving this, boards demonstrate value to host countries and reduce potential tension with citizen stakeholders over human development strategies. Most importantly, by being proactive boards avoid the risk of being preempted by regulators. Equally, to reduce impacts of the risk of political economy based policies that decentralize power from the Executive Branch of a country, SOEs could make greater use of relevant parliamentary committees for oversight of partnerships and SOEs.

4. Conclusion

My discussion of the four committees above should not be misconstrued to mean others are less important for governance purposes, but instead be appreciated for their central role given the type of industries and the business environment of partnerships and SOEs. Others, including investment, remuneration, executive and innovation committees, are just as important. But, just as is the case with boards, regardless of the type of committee, its effectiveness cannot be taken for granted. Features of an effective committee therefore remain, a clear purpose and goals, and effective chairperson, aligned with the board, and its members' commitment to diligence. This and a thorough understand of responsibilities guides decisions. To continuously improve, committees must also subject themselves to routine performance evaluation by third parties.

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This blog is part of on series on:

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