



Defining best practice in corporate occupational health and safety governance

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Defining best practice in corporate occupational health and safety governance

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The Health and Safety Commission's 'Revitalising Health and Safety' Strategy, published in 2000, makes explicit reference to the board and directors' role in driving improvements in health and safety performance within both public and private sector organisations. HSC/E considers it essential that company directors take responsibility for this within their organisations. However, evidence suggests that in many sectors there is still a lack of engagement at the highest levels in UK organisations – and that directors are still unclear as to their role in Occupational Health and Safety (OHS) leadership and in ensuring that risks to OHS within their business are properly controlled.

This project has been commissioned to help the understanding of how OHS fits within more traditional Corporate Governance and the benefits an integrated approach can bring. The authors have deliberately sought best practice in OHS governance across UK industry, to better understand the key elements of good practice. They have investigated the roles of the board, both individually and collectively, and explored the overlaps between good practice governance of OHS and the more traditionally accepted standards in Corporate Governance.

The report presents an outline framework for what, in the authors' view, Best Practice in OHS Governance looks like. This framework consists of seven basic principles covering: director competence; director roles and responsibilities; culture, standards and values, strategic implications; performance management, internal controls; organisational structure. The report also suggests expanding on the existing guidance on directors' responsibilities for OHS, presented in INDG343, to include some of these elements.

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Insight Investment is one of the UK's largest institutional investors. They manage £95.5bn (as at 31 March 2006) on behalf of some 300 pension funds and, ultimately, for several million individual savers. They have a long-standing commitment to support and encourage company boards in their effort to achieve high standards of corporate governance. This commitment is backed by one of the largest and most experienced corporate engagement teams in the City. Insight Investment believes that corporate governance is about providing the entrepreneurial leadership for the business necessary to create shareholder value over the long-term. Over the last three years Insight's Investor Responsibility team has engaged with over 200 companies on issues of corporate governance and corporate responsibility. They have sought to encourage all of the companies in which they invest to achieve the standards set by the best and to encourage the best to reach even higher.

THE AUTHORS

Acona Ltd

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- Safety and Environment
- Sustainable Business

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We have offices in Stavanger, Oslo, Aberdeen and London and clients in all sectors including retail, leisure, manufacturing, energy, the public and not-for-profit sectors. Our activities range from sharing and managing technical risk on major oil and gas projects through to helping corporations understand the new issues arising from the challenge of sustainable development.

Acona has a unique combination of relevant Board level experience in corporate responsibility and the operational aspects of HSE and risk management.

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The full list of named consultees is included as Appendix A.

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EXECUTIVE SUMMARY

The HSC's mission is to ensure that risks to people's health and safety from work activities are properly controlled. Furthermore, the HSC/E are encouraging business to move beyond regulatory compliance, recognising the social and economic benefits such an approach brings. The Government and HSC's 'Revitalising Health and Safety' Strategy, published in 2000, makes explicit reference to the board and directors' role in driving improvements in health and safety performance. HSC/E consider it essential that company directors take responsibility for this within their organisations.

However, evidence suggests that in many sectors there is still a lack of engagement at the highest levels in UK organisations – and that directors are still unclear as to their role in occupational health and safety (OHS) leadership and in ensuring that risks to OHS within their business are properly controlled. Furthermore, the existing HSC guidance on directors' responsibilities for OHS (INDG343) no longer reflects best practice governance in large UK companies and is in need of updating. The distinction between the role of executive managerial responsibilities and the governance role of the board of directors is not clear – even though some directors may be performing both functions.

EXISTING GUIDANCE

INDG343 gives five key action points for directors to embrace:

- Acceptance by the board of its role in H&S leadership;
- Acceptance by individual board members of their role;
- To consider the health and safety implications of all board decisions;
- To engage the workforce in H&S matters;
- To appoint a board health and safety 'champion' – a nominated H&S director who will take the lead on ensuring that the board's H&S responsibilities are properly discharged.

The actions and guidance set out in the document are clear, concise and understandable. It quite correctly covers the role of board oversight and leadership, the importance of policy setting and the role of OHS issues in corporate decision making. However the OHS governance debate has moved on since INDG343 was published, and in terms of a present day guidance document it could be enhanced in a number of ways.

In broad terms it would be helpful to evidence the benefits (business and social) that board and director responsibility brings to the control of risks associated with OHS. Also, to describe the key competences that boards of directors need in order to discharge this responsibility, or provide advice or guidance on how to develop the necessary competence.

More specifically, it would be useful to provide more detailed guidance on:

- How to incorporate OHS into existing governance structures (which for large companies involves the Internal Control procedures, and the Audit and Remuneration Committees);
- The role of non-executive directors vs. executive directors;
- How to effectively implement OHS management delegation;
- How to set objectives and monitor performance of the business; and
- How to incentivise the executives to deliver good OHS performance.

THE PROJECT

This project has therefore been commissioned to help understanding of how OHS fits within corporate governance and the benefits an integrated approach can bring. The authors have deliberately sought best-practice in OHS governance across UK industry to better understand the key elements of good practice. They have investigated the roles of the board, both individually and collectively, and explored the overlaps between good practice governance of OHS and the more traditionally accepted standards in corporate governance.

The work has benefited from interviews with a number of leading organisations – both national and global players – who have shared their thinking. Given the breadth of the subject, we have focussed mainly on large listed companies, although our conclusions are likely to have resonance with public sector organisations and Small and Medium Enterprises (SMEs).

WHAT IS GOVERNANCE AND WHY IS IT DIFFERENT FROM MANAGEMENT?

Put simply, ‘governance’ is the system by which organisations are directed and controlled by their boards of directors. It is distinct from ‘management’ – which can be thought of as the regular day-to-day decisions and actions required to run the business. ‘Governance’ refers to the higher level processes by which managers are held to account and through which the broadest strategic decisions are taken.

Jacqui Boardman, Acona Ltd

BEST PRACTICE FRAMEWORK FOR OHS GOVERNANCE

The outcomes of this project suggest that there is no ‘one-size fits all’ solution for OHS governance, since the structures and levels of engagement do vary with the materiality of OHS issues and size and complexity of the organisations involved. But there are some fundamentals that have been evident in the research.

An outline framework for what Best Practice in OHS governance looks like has been identified, consisting of **seven basic principles** covering:

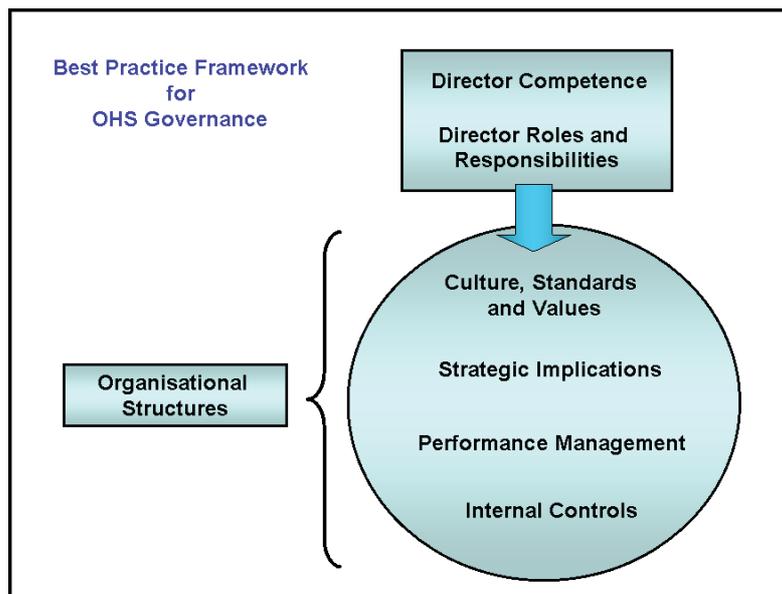


Figure 1 Best Practice Framework for OHS Governance

The seven key principles are outlined below and discussed in greater detail within the main body of text:

BEST PRACTICE PRINCIPLES FOR OHS GOVERNANCE

Director competence

All directors should have a clear understanding of the key OHS issues for their business and be continually developing their skills and knowledge.

Director roles and responsibilities

All directors should understand their legal responsibilities and their role in governing OHS matters for their business. Their roles should be supported by formal individual terms of reference, covering as a minimum setting OHS policy and strategy development, setting standards, performance monitoring and internal control.

At least one nominated director (which could be the Chairman or preferably one of the independent non-executive directors, where they exist) should have the additional role of overseeing and challenging the OHS governance process.

Culture, standards & values

The Board of Directors should take ownership for key OHS issues and be ambassadors for good OHS performance within the business, upholding core values and standards. They should set the right tone at the top and establish an open culture across the organisation with a high level of communication both internally and externally on OHS issues.

Strategic implications

The board should be responsible for driving the OHS agenda, understanding the risks and opportunities associated with OHS matters and any market pressures which might compromise the values and standards, and ultimately establishing a strategy to respond.

Performance management

The board should set out the key objectives and targets for OHS management and create an incentive structure for senior executives which drives good OHS performance, balancing both leading and lagging indicators and capturing both tangible and intangible factors. Non-executives (through the Remuneration Committee, where one exists) should be involved in establishing the appropriate incentive schemes.

Internal controls

The board should ensure that OHS risks are managed and controlled adequately and that a framework to ensure compliance with the core standards is established. It is important that the governance structures enable management systems, actions and levels of performance to be challenged. This process should utilise, where possible, existing internal control and audit structures and be reviewed by the audit committee.

Organisational structures

The board should integrate the OHS governance process into the main corporate governance structures within the business, including the activities of the main board and its sub-committees, including risk, remuneration and audit. In some cases, the creation of an additional board sub-committee to consider OHS (and/or Risk/Corporate Responsibility) may be relevant.

CONCLUSIONS AND RECOMMENDATIONS

There is an ongoing debate on the need for further regulation of directors' duties for health and safety, with two private members bills having been brought to the UK Parliament on this issue in recent years and a commitment from the HSE to express their views to Government on this subject during 2006. The HSC/E are currently undertaking work to identify the practicability, feasibility and effect of placing new legal duties on directors in respect of OHS.

The findings of this study, however, suggest that there would be strong support among a number of stakeholders for re-visiting and re-issuing the guidance and including in that specific elements of the findings of this report on the emerging best practice in OHS governance.

Indeed, one of the most consistently expressed views from the directors interviewed was that there was (a) sufficient regulation controlling OHS in the workplace and enabling prosecution of directors should things go wrong and (b) an urgent need for improved advice and guidance (and even support) from the regulators to enable directors to take better control of OHS within their organisations.

Such guidance must be written in a vocabulary that directors will understand; cover the issues that really matter and put the guidance in the language of the board: the language of risk, opportunity, efficiency, market vision and shareholder value – the language of corporate governance. The principles defined above together with the examples given in the main body of the text could provide a sound basis for future development of a director's guidance document on OHS Governance (to enhance INDG343), which is recommended.

1. INTRODUCTION

The HSE and their governing body the HSC have been in existence for more than three decades. The HSC's mission is to ensure that risks to people's health and safety from work activities are properly controlled (1). Furthermore, the HSC/E are encouraging business to move beyond regulatory compliance, recognising the social and economic benefits such an approach brings. The Government and HSC's 'Revitalising Health and Safety' strategy (1), published in 2000, makes explicit reference to the board and directors' roles in driving improvements in health and safety performance. HSC/E consider it essential that company directors take responsibility for this within their organisations.

The HSE has a considerable work programme in place incorporating the promotion of directors' responsibilities and leadership, the development of persuasive business benefit and director leadership case studies, and the development of the Corporate Health and Safety Performance Index (CHaSPI) and the health and safety performance indicator for SMEs.

From discussions with stakeholders, HSE has concluded that OHS is a key issue that needs to be embraced by more established corporate governance arrangements, such as the roles of board committees, internal control and audit. Failure to control OHS risks properly can have a damaging effect on the business, its employees and others on whom its work activities impact – these are crucial matters for corporate governance.

The most important governing institution of a business or other organisation is the board of directors as a collective. However, in a recent survey conducted on behalf of HSE, 21% of large public, private and voluntary sector organisations* in the UK still state that they do not direct OHS at board level (2).

The debate catalysed by the HSE work programme and broader discussions on directors' responsibilities and duties for OHS have highlighted that the HSE is yet to define its overarching policy regarding how boards should govern health and safety issues. This is an important gap that this research project seeks to bridge by defining and establishing new standards of best practice in the area of corporate OHS Governance.

For readers who are already fully aware of the debate on governance and corporate responsibility, it is recommended that you pass over Sections 2 to 7.

* *Despite the fact that the number of large organisations who report that health and safety is directed at a board level has risen from 58% in 2001 to 66% in 2003 and 79% in 2005 – taken from page 13, reference 2.*

2. BACKGROUND TO THE WORK

In general, it is the role of the board of directors to agree a company's overall policy and strategy. The board is also responsible for motivating and reviewing performance, and for disclosing this performance to shareholders. All of these roles relate to OHS in some way. To provide three broad examples:

- Do boards recognise the strategic relevance of good OHS management and what key measures of performance they should disclose to investors and other stakeholders including, importantly, workers?
- What is best practice in how boards delegate responsibility for OHS, how should they monitor performance in this area, and what is the specific function of non-executive directors in this regard?
- How should incentive structures of the executive directors, non-executive directors and the senior management be designed in order to motivate appropriate OHS performance?

The authors have deliberately sought best-practice in OHS governance across UK industry, in order to help understand what the key elements of good practice actually are. In order to identify organisations exhibiting good practice, the authors have taken recommendations from both the regulatory and investor communities, whilst simultaneously asking sector groups about organisations they admired and who in their view were governing OHS well.

They have investigated the roles of the board, both individually and collectively, and explored the overlaps between good practice governance of OHS and the more traditionally accepted standards in corporate governance.

The work has benefited from interviews with a number of leading companies, organisations and individuals – both national and global players – who have shared their thinking (listed in Appendix A). Given the breadth of the subject, the focus has been mainly on large listed companies, but the authors also believe that the conclusions have relevance for public sector organisations and to a large extent Small and Medium Enterprises (SME).

3. GOVERNANCE VS MANAGEMENT

WHAT IS GOVERNANCE AND HOW IS IT DIFFERENT FROM MANAGEMENT?

Put simply, ‘governance’ is the system by which organisations are directed and controlled by their board of directors. It is distinct from ‘management’ – which can be thought of as the regular day-to-day decisions and actions required to run the business. ‘Governance’ refers to the higher level processes by which managers are held to account and through which the broadest strategic decisions are taken.

Within large listed companies, shareholders have the responsibility to appoint the board of directors, whereas for other organisations, directors may be self-appointed, appointed by the organisation’s members or may be nominated by the overall governing body (eg national government in the case of public sector boards). The board acts on the appointees’ behalf to ensure their interests, and those of other stakeholders, are protected and maintained.

Hence the role of the board is to govern and not to manage. It is about setting the overall direction for the business or organisation, establishing boundaries within which the organisation operates and monitoring its performance. Effective board governance therefore provides a sound basis for long-term value creation and is fundamental to business prosperity.

“It is board leadership which generates the drive on which the growth of individual companies and of the economy as a whole depends.”

Sir Adrian Cadbury (3)

CORPORATE GOVERNANCE

So what is ‘**corporate governance**’ and how does this relate to OHS?

The term **corporate governance** came to prominence with the Committee on Financial Aspects of Corporate Governance, set up under the Chairmanship of Adrian Cadbury in 1991[†] to address concerns over standards of financial reporting and accountability. They were the first group to explicitly define board responsibilities in governing business activity within a framework of corporate governance (4).

“As members of the unitary board, all directors are required to:

- Provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enable risk to be assessed and managed;
- Set the company’s strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives, and review management performance; and
- Set the company’s values and standards and ensure that its obligations to its shareholders **and others** are understood and met.”

The above quote has been taken from principle A.1 of the guidance contained within the **Combined Code on Corporate Governance**, which supersedes (and contains the core elements of) the earlier Cadbury report and now is seen to represent UK best practice (5). Adherence to this code is a listing requirement and its content has broad support from institutional investors.

The Combined Code makes oblique reference to OHS in a number of ways. The requirement for a company to set the company’s ‘values and standards’ and to meet ‘obligations to its shareholders and

[†] by the Financial Reporting Council, the London Stock Exchange and the accountancy profession.

others' requires a duty of care, as a minimum, to its employees, customers and any third parties it comes into contact with. In addition, the code's principles on risk management state that: the board should consider the nature and extent of risks, the likelihood of the risks occurring, the acceptable level of risk and the costs and benefits of risk control mechanisms. Whilst this is generally taken to refer to financial risks, the Code specifically includes within the definitions in its appendices risks relating to reputational, legal and health and safety issues. Further, the board must be supplied in a timely manner with the information required to discharge their duties and maintain a sound system of internal control, both of which can be taken to include non-financial metrics such as health and safety performance.

Assessing the effectiveness of the company's risk and control processes

“Are the significant internal and external operational, financial, compliance and other risks identified and assessed on an ongoing basis? (Significant risks may, for example, include those related to market, credit, liquidity, technological, legal, **health, safety** and environmental, reputation, and business probity issues.)”

Page 39, The Combined Code (5)

KEY ELEMENTS OF GOVERNANCE

To summarise the key elements of governance, for which boards of directors are responsible are:

1. Leading the business and establishing the overall strategic direction;
2. Setting values and standards for the business and clear objectives for management – and delineating the limits of their responsibility;
3. Holding management to account for their performance in running the business;
4. Upholding obligations to the shareholder and other interested parties;
5. Overseeing internal controls.

In setting the strategic aims for the business, the board will benefit from a fundamental understanding of the role OHS plays in the overall performance of the business. Furthermore, their leadership role and influence in setting clear values and standards to work by, is key to establishing the culture of the organisation, including that related to OHS.

4. CORPORATE RESPONSIBILITY AND ITS RELATIONSHIP WITH OHS GOVERNANCE

The corporate responsibility (CR) agenda has become more prevalent over the last decade. Amongst many other descriptions, CR can be defined as the integration of economic, social, ethical and environmental concerns within all business activities and operations. Over the last five years HSC/E have been actively pursuing engagement with key stakeholders to raise the prominence of OHS within the CR agenda.

This report has benefited, in particular, from recent work with Insight Investment, the FTSE Group, and Business in the Community (BITC) which considered how CR (of which OHS forms a part) relates to the overall debate on corporate governance, regulation and company value creation (6). Their *Rewarding Virtue* report examines why CR is of central importance to business, why boards have a decisive role to play in implementing it and what principles drive effective board action. The report argues that:

“Corporate responsibility is a precondition for sustainable long-term value creation. But many powerful pressures and temptations can drive businesses off course, unless proactive steps are taken to respond to them. Boards have a decisive role to play in doing this; creating companies where responsible behaviour is second nature. The secret of success is to ensure that – in choosing strategy, approaching regulation, designing incentives, shaping the organisational culture, and overseeing internal control – virtue is rewarded.”

Rewarding Virtue identified a number of key principles which define best-practice in CR governance, through which a series of standards to supplement and reinforce the Combined Code have also been suggested (6). In summary these are to:

- **Set clear values and standards** - Be clear about the terms of the corporate responsibility contract (with all stakeholders), set explicit standards and values for the business;
- **Think strategically about corporate responsibility** – Understand the problems in your markets, and design a business model that avoids them;
- **Be constructive about regulation** – Support both self-regulation and government intervention to correct structural problems in markets;
- **Align performance management** – Reward responsible success over the long-term, and not just meeting narrow financial targets over the short-term;
- **Create a culture of integrity** – Set the right tone at the top and entrench the right values in the corporate culture;
- **Use internal control to secure responsibility** – Safeguard the company’s standards with robust internal audit and control systems.

The key arguments in the research reinforce the view that governance is about leadership and controls, setting targets, holding management to account and understanding and discharging duties to shareholders and others – all of which overlap both with CR and OHS. If the board is doing its governance role properly then it must take account of its responsibilities, one of which is to address occupational health and safety.

5. PROBLEMS WITH THE EXISTING HSC/E GUIDANCE ON OHS GOVERNANCE

In 2002, The **Health and Safety Commission** produced INDG343, outlining ‘Directors Responsibilities for Health and Safety’ (7). This explicitly defines governance processes for OHS, giving five key action points for directors to embrace:

- Acceptance by the board of its role in H&S leadership;
- Acceptance by individual board members of their role;
- To consider the health and safety implications of all board decisions;
- To engage the workforce in H&S matters;
- To appoint a board health and safety ‘champion’ – a nominated H&S director who will take the lead on ensuring that the board’s H&S responsibilities are properly discharged.

The actions and guidance set out in the document are clear, concise and understandable. It quite correctly covers the role of board oversight and leadership, the importance of policy setting and the role of OHS issues in corporate decision making. However the OHS governance debate has moved on since INDG343 was published, and in terms of a present day guidance document it could be enhanced in a number of ways.

In broad terms, it would be helpful to evidence the benefits (business and social) that board and director responsibility brings to the control of risks associated with OHS. Also, to describe the key competences that boards of directors need in order to discharge this responsibility, or provide advice or guidance on how to develop the necessary competence.

More specifically, it would be useful to provide more detailed guidance on:

- How to incorporate OHS into existing governance structures (which for large companies involves the Internal Control procedures, and the Audit and Remuneration Committees);
- The role of non-executive directors vs. executive directors;
- How to effectively implement OHS management delegation;
- How to set objectives and monitor performance of the business; and
- How to incentivise the executives to deliver good OHS performance.

The following lists some examples of practical guidance currently not covered by INDG343 that directors spoken to in the course of this work would welcome:

- As a company director how do I make sure that my responsibilities are discharged adequately?
- How will I know good practice and effective performance when I see it?
- What risk and performance information should I ask for and report to the board?
- How should incentive structures of the executive directors, non-executive directors and the senior management be designed in order to motivate appropriate OHS performance?
- What is best practice in how boards delegate responsibility for OHS, how should I monitor performance in this area, and what is the specific function of non-executive directors in this regard?
- What key performance indicators should we disclose to investors? Who else should I be communicating this to?
- Do I take advice from the H&S professionals in my own organisation – the exact same individuals I am meant to be leading, incentivising and monitoring? If so, where is the independence in the system?

6. DRIVERS FOR BEST- PRACTICE OHS GOVERNANCE

So what are the key drivers for boards to exhibit good practice in OHS Governance? Broadly, they can be categorised as moral, legal and financial. The balance between each of these three varies with each organisation. Specific drivers range from intangibles such as the personal drive and self interest of the senior directors, through to more tangible factors such as avoiding future bottom line impacts, or standard requirements of the client base.

The level of director engagement in OHS also varies between organisations and sectors and is dependent on the size of the company, the perceived risks and legislative constraints. Not surprisingly the greater the drivers, the greater the levels of engagement of the directors and senior management. But there are exceptions. A particularly determined, inspired and/or knowledgeable Chief Executive Officer (CEO) or director can often drive the agenda irrespective of the perceived drivers for the business.

MORAL RESPONSIBILITY

Any business operates with the consent of society as a whole. Be that by adhering to specific legal constraints such as company laws, or, more broadly, due to general societal acceptance of the 'business they are in' and the trust that they will operate within generally accepted 'good business practice'. As a consequence of this, business leaders have a moral obligation not to abuse the trust placed in them by broader society.

At a basic level, moral responsibility for OHS manifests itself in a '**duty of care**' for employees, customers and all others affected by a particular business operation. At a more complex level, business has a responsibility to respond to societal concerns over OHS, particularly where the concerns doubt the basic duty of care.

Example moral drivers:

- Personal drive of the CEO and directors, recognising they have a moral responsibility to keep their workforce safe and healthy;
- General duty of care for employees and others affected by work activities;
- Responding to societal concerns, especially post major accidents such as King's Cross, Clapham Junction etc.

LEGAL RESPONSIBILITY

More formally, business is subject to a wide range of legal obligations placed on it by the society in which it operates. In OHS terms, the majority of these legal constructs focus on the employer's responsibility for **managing** OHS issues, rather than the duties of the board or, more specifically, individual directors. However there are some exceptions, which are discussed below.

Example legal drivers:

- Desire to comply with the law;
- Fear of prosecution and the imposition of penalties;
- A good compliance record can be critical to the licence to operate;
- Fear of the consequences of major incidents.

DIRECTORS' DUTIES

Currently there are no specific **positive duties** on directors for governing OHS – this is the subject of an ongoing government debate (8). The articulation of legal responsibilities for **managing** OHS primarily resides within the Health and Safety at Work etc. Act 1974 (9) (HASAW) and related statutes (see sections below). However, HASAW imposes its main obligations upon employers. The duties imposed are direct duties, requiring compliance. Only Section 37(1) of the Act explicitly mentions directors accruing criminal liability when a **corporate body** is found to have committed an offence with their 'consent or connivance' or to have stemmed from their 'neglect.' This duty is an **indirect duty**, existing only in the context of prosecution. **Positive duties** are placed on directors only in the context of being an employer, or under Section 7 of HASAW, which imposes duties in the context of also being an employee.

Health and Safety at Work etc. Act 1974, Section 37(1) – Offence of Directors

“Where an offence under any of the relevant statutory provisions committed by a body corporate is proved to have been committed with the consent or connivance of, or to have been attributable to any neglect on the part of any director, manager, secretary or other similar officer of the body corporate or a person who was purporting to act in any such capacity, he as well as the body corporate shall be guilty of that offence and shall be liable to be proceeded against and punished accordingly.”

Health and Safety at Work etc. Act 1974, Section 7 – Offence of Employees.

“It shall be the duty of every employee while at work

(a) to take reasonable care for the health and safety of himself and of other persons who may be affected by his acts or omissions at work; and;

(b) as regards any duty or requirement imposed on his employer or any other person by or under any of the relevant statutory provisions, to co-operate with him so far as is necessary to enable that duty or requirement to be performed or complied with.”

The Management of Health and Safety at Work Regulations 1999, Regulation 5(1) Health and Safety Arrangements – Offence of an Employer.

“(1) Every employer shall make and give effect to such arrangements as are appropriate, having regard to the nature of his activities and the size of his undertaking, for the effective planning, organisation, control, monitoring and review of the preventive and protective measures.

(2) Where the employer employs five or more employees, he shall record the arrangements referred to in paragraph (1).”

CORPORATE MANSLAUGHTER

Underpinning the debate about director responsibility for H&S (10Error! Bookmark not defined.) will be the impact of the new draft **Corporate Manslaughter Bill** (10). The draft Bill was published in 2005. It proposes a new criminal offence of *corporate manslaughter*, which will apply when someone has been killed because the senior management of a corporation has "grossly failed to take reasonable care for the safety of employees or others". Although this is directed at the 'body corporate' and not the individual, it is anticipated that this will have a significant influence on directors taking responsibility for ensuring effective health and safety management, particularly if the sanctions are high in the event of failure to do so.

FORMAL COMPANY DISCLOSURE

Over the past few years, there has been some debate over possible changes to company disclosure requirements to enable further disclosure of information on non-financial issues. Both medium and large companies in the UK are now required to produce an 'enhanced directors report', as a part of the implementation of the new EU Accounts Modernisation Directive (11,12). This should include non-financial information about company performance, especially in relation to company employees.

“To the extent necessary for an understanding of the company's development, performance or position, the analysis shall include both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters”

EU Accounts Modernisation Directive (11Error! Bookmark not defined.)

Where it is a significant issue for the business, we might expect to see OHS information presented in the enhanced directors' report. Indeed, boards have already been considering which key performance indicators (KPIs) they will disclose in this way. Recent surveys conducted on behalf of HSC/E reveal that 96% of the FTSE100 already include aspects of OHS management in their annual reporting (13) – the number of FTSE100 companies reporting OHS has almost doubled over the last ten years.

FINANCIAL ADVANTAGES

There are numerous financial drivers encouraging directors to take responsibility for the governance of OHS. The most obvious of which can be the direct impact on the bottom line from good OHS performance and the avoidance of prosecutions following governance failures (the latter point is covered in more detail in the next section). Further examples are illustrated below.

In the private sector, **investors** can be key to influencing board action on OHS and they are increasingly using this influence to promote good governance. Recent publications from **Hermes**, “Corporate Governance and Performance” (14) and **Barclays Global Investors**, “Corporate Governance Policy” (15), among others, address, respectively, the link between the active promotion of good corporate governance and long term shareholder value and the corporate governance policies and practices companies invested in are encouraged to adopt. Further, a broader review of institutional investor policies revealed significant levels of interest in H&S (something actively encouraged by the HSE) (16).

Example financial drivers:

- Core to enhancing / protecting company image
- Wanting to lead the sector in OHS – establishing a good safety record as a market differentiator
- Peer pressure – not wanting to be the laggard in the sector
- General good business practice
- Financial advantages – bottom line savings, especially if reducing insurance premiums, fines, sickness absences etc.
- Fundamental to winning contracts with clients / business partners, gaining bank loans and external investments – eg role of standards like OHS18001
- Investor interest, especially from socially responsible investment (SRI) investors for example: Henderson, Insight Investment, Jupiter, Morley and USS
- Managing reputational and financial risk
- Fear of adverse publicity
- Trade union / employee pressure
- Customer pressure
- Perception of earning autonomy from the regulators and hence reducing costs of compliance

Insight Investment has taken a particularly proactive role in ensuring that companies meet the highest H&S standards, not only through direct engagement, but also by helping HSE understand the issues surrounding OHS governance and in identifying the potential benefits that Best Practice Principles for OHS Governance could bring. They have supported the development of HSE's Corporate Health and Safety Performance Index (CHaSPI) (17), organised OHS conferences and workshops and co-funded this current piece of work (18).

Henderson Global Investors has been supporting research into the key elements of corporate governance (including OHS governance) for some time, in particular analysing the role non-financial indicators play in the incentive structures incorporated into director's remuneration packages (19) and more recently has played a leading role in its work with HSE and FTSE100 companies in promoting the adoption of standards for the management of workplace stress (20).

Jupiter, Morley, Standard Life and the **Universities Superannuation Scheme**, among other investors, have also supported the development of CHaSPI case studies (which demonstrate the business benefits well-managed OHS brings) and the promotion of greater director responsibility for OHS by the HSC/E.

7. THE COSTS AND SYMPTOMS OF OHS GOVERNANCE FAILURE

Given the range of drivers for adopting good OHS practice, at least a few of which will touch any organisation, why is there such an apparent lack of engagement among many corporate directorships? And more importantly, how and why does governance fail and what are the implications of such failure?

The report has established that good OHS governance is linked to long term prosperity and value creation. Conversely, failure to govern effectively can result in significant financial losses – not only through catastrophic accidents in high hazard industries, but more systematically through the constant drain on resources of work-related ill-health and sickness absences.

Ideally, there should be a demonstrable link between good OHS performance and improved share price. However, findings of this kind are elusive, but one study, cited in Mansley 2002 (16), from Australia does point in this direction. The research by Westpac Investment Management and Monash University Accident Research Centre (21) found a positive link between OHS performance and financial returns. They developed a test that assessed the integration of sound OHS policies and practices in organisations. This was then applied to some 150 listed companies (based on capitalisation). An investment portfolio limited to those companies that passed the test was then compared to a benchmark portfolio of all 150 companies. The portfolio of ‘good OHS companies’ outperformed consistently over the nine-year test period, by around 50-60 basis points (bps) on average (16).

At the macroeconomic level, the International Labour Organisation (ILO) has estimated that global financial losses due to workplace injuries and ill health exceed \$1,250 billion (22). In the UK, HSE’s statisticians have calculated that in 2001/02 the total costs to society of health and safety failures amounted to between £20 billion and £31.8 billion.[‡] At a microeconomic (or company) level, the financial costs of poor OHS management include both direct costs in the event of health and safety incidents (e.g. fines, compensation, insurance, sick pay) as well as the indirect costs associated with such incidents (e.g. lost productivity, costs of management time in dealing with incident, reduced staff morale, tarnished corporate image).

The HSE estimate the underlying costs of accidents and ill-health to UK employers to be up to £6.5 billion per year with up to 35 million working days lost – 28 million attributable to ill-health and 7 million to injury; costs of long-term sickness absence also amounts to over £3.8 billion (23). Furthermore, fines for health and safety management failures have increased. As Transco recently experienced, the price of failure is high – being fined almost 1% of their annual pre-tax profits for two major gas explosions in the UK.[§] In addition, there are a number of hidden costs associated with loss of reputation, loss of custom and enhanced regulation and investigation.

"Society as a whole pays when things go wrong. We estimate that the total cost to society of health and safety failures could be as high as £18 billion every year. We can and should do something about this."

John Prescott UK Deputy Prime Minister 2000 (1)

[‡] <http://www.hse.gov.uk/statistics/pdf/costs.pdf>

[§] In August 2005, Transco was fined a total of £15m for gas pipeline explosion in Larkhall near Edinburgh and, in October 2005, a further £1m for a gas explosion in Ashton-under-Lyne, Greater Manchester.

UK COMPLIANCE RECORD – EVIDENCE OF GOVERNANCE FAILURES IN MAJOR INCIDENTS

So what has the compliance record to date suggested? Has recent case law identified specific evidence of governance failure in major incidents?

In 1987, the investigation into the sinking of the Herald of Free Enterprise suggested that the directors (along with others in the organisation) were guilty of fault (24):

"All concerned in management, from the members of the board of directors down to the junior superintendents, were guilty of fault in that all must be regarded as sharing responsibility for the failure of management. From top to bottom the body corporate was infected with the disease of sloppiness."

The Inspector charged with the Investigation into the King's Cross Underground Fire in 1987 blamed the board for having loose supervision on the OHS of a subsidiary company (25):

"In my view it is imperative that a holding company charged with ensuring safety of operation should discharge its duty fully. It is not acceptable that it should try to discharge that duty by delegating it to its subsidiary, coupled with maintaining a loose supervision by having on the board of the main company a director of the subsidiary company."

The investigation into the Clapham Junction Railway Accident of 1988 suggested that, although there was a sincerity of concern for safety, the organisation had failed to carry that concern into action (26):

"It has to be said that a concern for safety which is sincerely held and repeatedly expressed but, nevertheless, is not carried through into action, is as much protection from danger as no concern at all."

FACTORS LEADING TO OHS GOVERNANCE FAILURE:

Within large organisations there can often be a number of reasons:

- Failure of board to take control;
- Abdication to one nominated H&S director (as a scapegoat) or worse still senior management with no support;
- Isolation of parts of the company – no adequate lines of communication to and from the board;
- Lack of resource assigned to OHS by the board;
- Failure to seek competent advice at all levels (both internally and externally);
- Not enough challenge in the system from the board downwards;
- Rubber stamping of management decisions by the board;
- Failure of communication between levels and parts of the business – particularly between senior managers/directors of sub-units;
- Lack of integration with partners in the business – often many players all managing safety separately.

For smaller organisations:

- They might overreach themselves;
- They might suffer from a lack of time;
- Directors are often not qualified to take on OHS issues and can't afford to seek advice;
- There are lots of issues to deal with for small business;
- Directors are often most senior managers and hence can have conflicting priorities.

In addition, for all organisations, short term demands such as a pressure to deliver market return (or even paying employee wages) might be in conflict with long-term investment requirements such as the purchase of adequate safety equipment, staff training etc.

8. GUIDANCE VS REGULATION?

So what is the way forward? There is an ongoing debate on the need for further regulation of directors' duties for Health and Safety (8, 27), with two private members bills having been brought to the UK Parliament on this issue in recent years and a commitment from the HSE to express their views to Government on this subject by the end of 2005. As noted above, the HSC/E are currently undertaking work to identify the practicability, feasibility and effect of placing new legal duties on directors in respect of OHS (8).

One of the most consistently expressed views from the directors (and others) interviewed as a part of this work,^{**} was that there was (a) sufficient regulation controlling OHS in the workplace and enabling prosecution of directors should things go wrong and (b) an urgent need for improved advice and guidance (and even support) from the regulators to enable directors to ensure effective control of OHS within their organisations.

There was wide support for the development of more detailed directors' guidance to supplement (or even replace INDG343 (7)) – which will take account of the range of organisations for which it will apply, including size, complexity and relative risks. This might be, for example, a directors' version of HSE's *Successful Health and Safety Management* (HSG65) (28) – which was widely complimented and supported as a management tool.

HSE's Successful Health and Safety Management - HSG65

This practical guide covers advice on:

- Developing effective H&S policies;
- How to organise H&S management within an organisation;
- Implementing policy, setting strategy and setting objectives and targets;
- Measuring H&S performance;
- Auditing and reviewing performance.

HSC Directors' Responsibility for Health and Safety - INDG343

The guide gives five key action points for directors to embrace:

- Acceptance by the board of its role in H&S leadership;
- Acceptance by individual board members of their role;
- To consider the health and safety implications of all board decisions;
- To engage the workforce in H&S matters;
- To appoint a board health and safety champion – an H&S director.

The strongly held view from this research was that the Government must not regulate something that is still unclear. Directors need to be told what is expected of them – what is good practice – before the Government can regulate against failures to comply.

Therefore, there is a need to change the way of thinking (a cultural shift), where OHS issues and their impact on business performance are clearly understood, before bringing in new legislation mandating directors to take control. The HSE have in some way started this shift through their *Revitalising Health and Safety* strategy statement, the *Business Involvement Programme*, the *Director Leadership Case studies* (29), the *Good Health is Good Business* campaigns and the *business benefits* case studies (30)^{††}.

^{**} Mainly from large industry-based UK/global organisations – see list at the beginning of this report.

^{††} In addition, the HSE has produced a pamphlet focused on leadership of OHS in the major hazards sector (INDG277).

9. WHAT DOES BEST PRACTICE IN OHS GOVERNANCE LOOK LIKE?

It is fair to say that the outcomes of this project suggest that there is no ‘one-size fits all’ solution for OHS governance, since the structures and levels of engagement do vary with the materiality of OHS issues and size and complexity of the organisations involved. But there are some fundamentals which have been evident in the research.

An outline framework for what best practice in OHS governance looks like has been identified, consisting of seven basic principles covering:

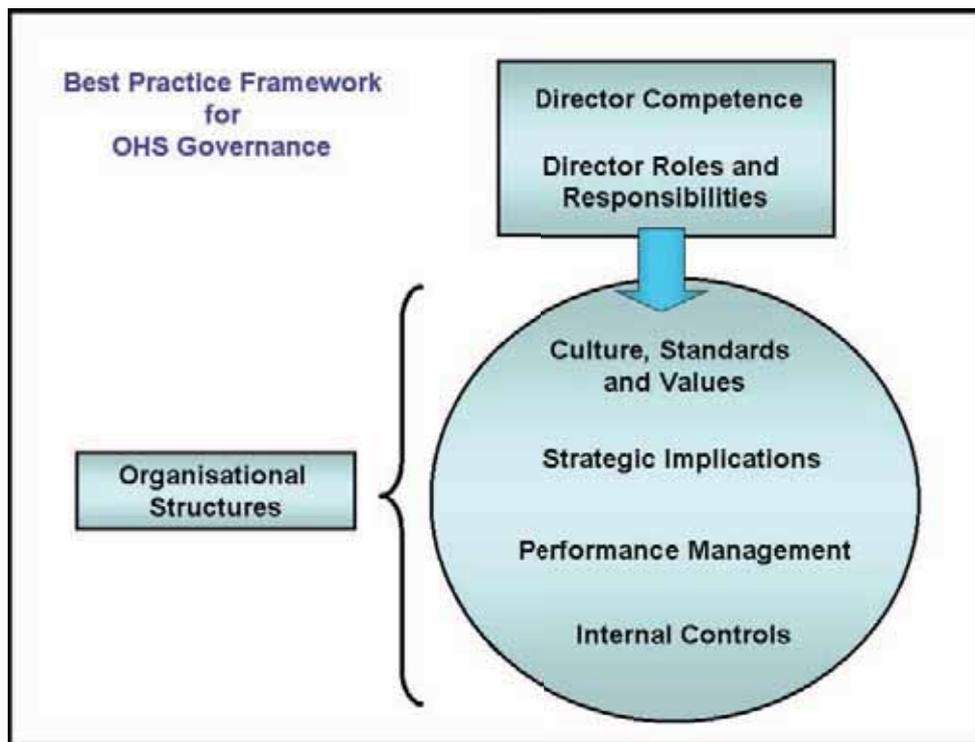


Figure 2 Best Practice Framework for OHS Governance

This framework has been developed using both the evidence revealed during the research (in talking to the organisations listed at the beginning and in Appendix A of this report), as well as the authors’ own understanding of the governance process.

DIRECTOR COMPETENCE

All directors should have a clear understanding of the key OHS issues for their business and be continually developing their skills and knowledge.

Quite a broad understanding of OHS matters was observed amongst all the companies interviewed. Boards were not simply debating the impacts on the bottom line from lost time accidents or risks to reputation from major events. The more enlightened organisations also had a clear knowledge of the ongoing costs of sickness absences, or intangibles such as public concerns about product safety.

The majority of directors also had a clear view of where their OHS performance sits in relation to their peers/others and understood the need for strict controls to maintain current or improved levels of performance.

Any board of directors should be open to debate on key OHS matters for the business and should be open to developing their skills and knowledge of these key issues, through external training, seminars and presentations etc. A number of organisations had engaged external advisors to attend board meetings and even sit on board sub-committees responsible for OHS matters. In several cases, OHS has been included into the formal induction 'packs' for new directors.

The level of knowledge was to some extent reflected by the different roles exercised by executive and non- executive directors, and further depended on the size, business and complexity of the company activities. All boards need to be satisfied that the company's obligations are being met and that performance is being appropriately monitored. The directors therefore need sufficient knowledge and information to allow them to do so. In particular, non-executive directors must be in a position to be able to monitor executive activity and contribute to the development of strategy (31).

At higher levels of engagement, we observed that directors were involved in intra and cross-sector OHS debates, e.g. through presentations at trade associations, public debates, conferences, and involvement in government committees.

One company interviewed held a health and safety champions forum twice a year which directors attended and debated key OHS topics for the business.

Another company often invited external speakers to present at board meetings on key OHS topics.

A third company had external OHS advisors sitting on their board risk sub-committee.

DIRECTOR ROLES AND RESPONSIBILITIES

All directors should understand their legal responsibilities and their role in governing OHS matters for their business. Their roles should be supported by formal individual terms of reference, covering as a minimum setting OHS policy and strategy development, setting standards, performance monitoring and internal control.

At least one nominated director (which could be the Chairman or preferably one of the independent non-executive directors, where they exist) should have the additional role of overseeing and challenging the OHS governance process.

All directors interviewed had a clear understanding of the role they played in governing OHS within their business and fully understood their legal responsibilities. Moreover they were aware of their obligations to 'shareholders and others' – at a basic level this represented their duty of care to customers and employees, at a more detailed level, the risks that OHS matters posed to the long term value of the business.

A number of organisations had formal terms of reference for the OHS role assigned to individual directors, the Board as a collective, the nominated Director of Health and Safety (where they existed), and in some cases separately for the CEO and the Chairman.

There was a strong feeling amongst all interviewees that **all board directors** should be equally responsible for the OHS governance process and in that sense perform an equal role. The nomination of a specific director for OHS matters (as described in INDG343 Action Point 5), was seen as a useful organisational tool, but this was most likely to be a senior manager rather than a board director. This individual would liaise on a more frequent basis with the executives and other senior managers and provide a formal reporting route to the board. In no way was this role seen as a substitute for the individual and collective roles and responsibilities of the whole board.

However, it was also seen as key that the board facilitates (as far as is possible) **independent challenge** to the governance systems employed. There are many ways in which this might be done (see also Internal Controls below), but ideally one or several of the non-executive directors (preferably independent) or the Chairman would be given a formal role to scrutinise the processes employed. Desmond Fennell QC in his investigation of the Kings Cross enquiry (25) suggested that, for companies where OHS presents a serious risk, there should be a non-executive director whose specific responsibility would be overseeing safety matters for the business.

It was also noted that Action point 3 of INDG343 (to ensure that all board decisions reflect OHS policy) (7) is often reflected in the formal terms of reference for the board directors.

Where OHS issues were considered significant enough to warrant the establishment of a formal board sub-committee, invariably formal terms of reference had been defined for these committees, including their composition and responsibilities and how they interacted with the main board.

The Chair, the Executive Director overseeing OHS, the appointed Non-Executive Director, the Chief Executive and the Finance Director, and any sub-committees will all have different roles to play in governing OHS. It is important that the various responsibilities are set down and that appropriate dynamics are established in boards to address occupational safety and health issues.

Example elements of the formal terms of reference (TOR) (a composite taken from a number of organisations' individual board members and board committee TORs):

- To review and agree OHS strategy;
- To develop an OHS policy statement which reflects the board's vision and priorities;
- To receive annual reports on progress, performance and implementation of the OHS plans;
- To ensure that sufficient resources are made available to achieve the implementation plan;
- To ensure that the workforce is actively involved in the management of OHS;
- To develop a communications plan to show the board's commitment to the strategy and ensure that the strategy and plans is communicated effectively to employees;
- To make sure the necessary organisational structures exist to ensure that OHS is properly managed;
- To ensure that all board decisions reflect the vision for OHS and the OHS policy;
- To clearly note reasons why the board has taken decisions which involve any significant degree of OHS risk;
- To be advised on all matters relating to OHS, especially major incidents and keep them fully informed of changes in safety legislation which might significantly affect the operations; and
- To ensure that audits are undertaken to monitor all aspects of OHS policy implementation.

CULTURE, STANDARDS & VALUES

The board of directors should take ownership for key OHS issues and be ambassadors for good OHS performance within the business, upholding core values and standards. They should set the right tone at the top and establish an open culture across the organisation with a high level of communication both internally and externally on OHS issues.

Establishing the right culture across the organisation is key to good performance. Organisational culture is driven from the top and visible levels of involvement in leading OHS strategy by the board makes a difference to the level of importance it is given throughout the organisation.

The board should debate and be clear on their values, policies and standards for OHS and make sure they reflect the overall vision they have for OHS within all business practice.

Values and standards are set by the board, and should cover the key areas that the company believes are essential for effective OHS management further down the organisation. Compliance with the standards should be a basic requirement of all parts of the business.

The Chairman and the CEO can often have a significant role to play in establishing a culture of openness and drive for better performance. Their communications both internally and externally set the tone for managing OHS within the business and can inspire confidence in the level of performance. Furthermore, where relevant, they can be a great influence for change. In particular, by being engaged in key OHS debates and self-regulation initiatives within their industry, encouraging good practice across their sector and being open and transparent about their own initiatives and performance.

Many boards do intrinsically recognise the strategic relevance of good OHS management. However, the general increase in concentration on health and safety (publicly and from investors) and the general need to manage corporate risk have been the most important reasons for adopting board level health and safety direction.

“As Chairman my role is to lead and inspire from the top. I have set out to make clear that whilst we want to create value for our shareholders, we also have a duty to contribute to wellbeing and safety in the community. Indeed I do not believe we can do one without the other.”

Sir David Arculus, Chairman O2 plc, Corporate Responsibility Report June 2005

Sir John Parker, Chairman of National Grid, takes an active role in leading OHS and Environmental Issues across their business. By way of an example, annually he leads the judging panel and presents the National Grid Chairman's Awards for Safety, Health and Environmental Achievement.

STRATEGIC IMPLICATIONS

The board should be responsible for driving the OHS agenda, understanding the risks and opportunities associated with OHS matters and any market pressures which might compromise the values and standards, and ultimately establishing a strategy to respond.

The directors should hold the overall vision for the company. It is therefore the key body for driving the OHS agenda and establishing the goals for the organisation.

The board should be conversant with any conflicts of interest that exist, eg market pressures, and understand the basic risks to the business and opportunities for development.

In several organisations interviewed, the board or a nominated board sub-committee was the key vehicle for debating company OHS strategy and setting the ultimate direction for the business. They took as input to the debate, both external and internal information on the key issues and risks faced by the business.

“It is my ambition to achieve world class health and safety performance in all of our businesses. We will therefore continue to set stretch targets, monitor and compare our performance and effectively communicate our achievements to all of our stakeholders”

“Our policy going forward will be to foster a common sense of purpose in an effort to create a culture that will significantly contribute to excellent and sustainable health and safety performance”

Ian Russell, former Chief Executive Scottish Power, Group Health and Safety Framework 2005

One major hazard organisation had fully evaluated the costs of absenteeism across the company and, when realising the level of impact on the bottom line was greater than the ongoing impact of accidents, the board approved major capital investment in an occupational health programme.

A telecoms company has set itself the aim of being in the upper quartile of FTSE 100 companies based on published accident statistics. They have used performance benchmarking extensively to drive their strategy. In addition to measuring themselves against FTSE 100 they:

- Internally benchmark between each division of the company;
- Measure against the IOSH telecoms specialist group; and
- Measure against European Telecom Network Operators (ETNO) forum.

PERFORMANCE MANAGEMENT

The board should set out the key objectives and targets for OHS management and create an incentive structure for senior executives which drives good OHS performance, balancing both leading and lagging indicators and capturing both tangible and intangible factors. Non-executives (through the Remuneration Committee, where one exists) should be involved in establishing the appropriate incentive schemes.

It is the boards' responsibility to establish the performance framework within which the business operates, in particular defining the incentive structures for the senior executives. This framework should include setting objectives and targets to meet the overall vision for OHS.

There was some debate during the interview process as to whether financial incentives (rather than a system of sanctions) should be given for good OHS performance. It was the view of many organisations that good performance should be expected, and they felt it more appropriate to issue sanctions, in the event of bad performance, rather than incentives for improvement. What is deemed appropriate will vary with the type and culture of the organisation, and should be evaluated on a case by case basis.

One key point is that undesirable and potentially conflicting incentives should be avoided within any remuneration and performance management system. For example targeting and incentivising on numbers of accidents and incidents may lead to a culture of hiding incidents and failure to report, rather than reducing actual numbers of incidents.

Key performance indicators must be specific to the business drivers and link in with the overall strategy. OHS performance management is multidimensional. No single measure provides an overriding indication of an organisation's success or failure in managing work related risk.

Reliance on lost time accident (LTA) data alone, for example, has the following drawbacks:

- It is beset with problems of under-reporting;
- It does not measure non-injury health and safety failures (e.g. near misses);
- It is beset with problems of statistical significance (small numbers etc);
- There is no automatic link between LTA performance and major hazard safety;
- Similarly there is no link between LTA performance and levels of health detriment; and
- It does not measure standards of health and safety management performance.

In 'Towards Best Practice' the Royal Society for the Prevention of Accidents (RoSPA) (32) has argued that a more holistic approach to performance assessment is required based on assembly of a 'portfolio' of 'leading indicators' (such as measures of 'culture' and measures of the integrity and performance of management systems) and 'lagging indicators' such as standards of control for principal risks (such as incidents, near-misses, financial losses).

The recent BP review of the incident at Texas City (33) suggested that a key failure in their governance processes was that they concentrated too heavily on lagging KPIs such as accident statistics and didn't sufficiently investigate and report on the actual adherence to their safety systems. They also suggested that by concentrating more on the details of near misses or more general process failures, they could in future avoid incidents with more major safety implications.

Through the research process, it was found to be commonplace for directors in high-hazard industries to have some elements of safety performance included in their remuneration packages – often the only non-financial metrics included. However, it was a common view across all sectors that non-financial measures such as OHS targets should not be used to the exclusion of financial performance to determine executive remuneration. Most companies interviewed had considered incorporating additional OHS targets alongside the financial measures used in more traditional incentive schemes, eg earnings per share or total shareholder return.

Interestingly, Henderson Global Investors suggest (19):

“The precise mix of metrics that best links strategy and remuneration will of course be specific to each individual company. But linking remuneration to a more balanced range of measures than is currently common helps to ensure that a focus on ‘ends’ (financial performance) does not cause the ‘means’ (management of a range of tangible and intangible assets) to be eclipsed.”

Several organisations interviewed had included a range of non-financial KPIs of which OHS was one, in their remuneration strategy for both executives and senior managers across the business. The use of these non-financial KPIs was in the main connected to short-term incentive schemes, such as annual bonus payments, rather than feeding into longer-term corporate growth / valuation incentives. In the majority of cases, however, the OHS incentive scheme kicked in at the board minus one level, i.e. at the top level of the operational chain, rather than applying to board directors (who were mainly targeted on corporate financial performance). The **remuneration committee** should have a key role to play in setting these incentives, although in many organisations they were not the key body establishing the OHS remuneration scheme. However, there were some examples of best practice:

One company interviewed had incorporated the results of an internal OHS audit framework (audit score) into a formalised balanced scorecard alongside more traditional financial metrics. A fixed percentage of the executive annual bonus for senior executives was based on the balanced scorecard which, in turn, was fed by an aggregated OHS audit score for their part of the business.

A good example of a composite performance management structure is that of Scottish Power. The company has instituted H&S as one of five main pillars in their ‘Leadership Expectations Model’. Senior executives are targeted on OHS performance which is judged against each one of 12 H&S standards defined for the business. The standards consider issues such as OHS leadership, training and levels of competence, risk management processes, through to accident investigation and analysis. To support the standards, they have established a detailed OHS framework and the picture illustrates the average performance across the business for 2004/5 against this framework. In setting targets for senior executives, the company benchmarks divisional performance against the best performers from across the business, and externally by comparing with other best practice organisations.

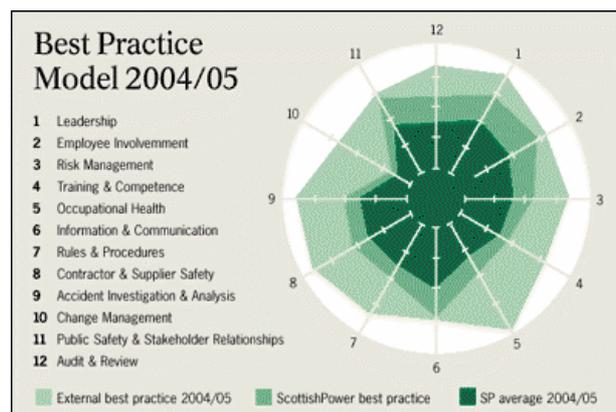


Figure 3 Scottish Power’s Best Practice Model 2004/05

BHP Billiton's incentive scheme operates on a set of health, safety, environmental and people-related targets, arranged around a corporate scorecard. A combination of lagging and leading indicators is used. The level of environmental incidents and safety figures are used as lagging indicators, and implementation of action plans to improve performance as leading indicators.

The Group OHS Scorecard applies to all Executive Committee members and incorporates KPIs on identifying risks, historical injury rates and incidences of occupational diseases, H&S fines and prosecutions, results of internal surveillance and audit programmes. These measures account for a minimum of 10% of the Scorecard. The figure is higher for individuals with specific responsibilities in these areas at Group level and within individual businesses.

The Remuneration Committee sets the Scorecard and reviews performance metrics annually.

The main board of BT has set H&S KPI targets based on the recommendations of their Group H&S Forum. However, these KPIs are part of a set used to manage the business and are not currently included in the Corporate Scorecard used to determine directors' remuneration. However, they suggest that although items on the scorecard are not specifically H&S related, this is implied within achieving business objectives and taken account of by the remuneration committee.

The HSE's Corporate Health and Safety Performance Index (CHaSPI)(17) can also be used as a key benchmark indicator of OHS performance. CHaSPI aims to help in the assessment of how well an organisation manages its risks and responsibilities towards its workers, the public and other stakeholders and if used in the right way could act as a powerful tool in measurement, and target setting. The table below shows an example set of results for RWE npower (published in 2006) in which the relative performance of a number of key OHS indicators is shown. The CHaSPI score could form one of the leading indicators within an executive balanced scorecard for OHS.

In summary, best practice has demonstrated that the board is actively involved in setting out the key objectives and targets for OHS management and devising incentive schemes to meet the OHS strategy for the organisation. This process is often driven by the non-executives (via the Remuneration Committee) in conjunction with the OHS professionals from within the business. The best examples show an incentive structure for senior executives which balances both leading and lagging indicators and captures both tangible and intangible factors (see for example Scottish Power above).

Organisation Summary Report					
PI #:	PI-01	Organisation ID #:	2130		
Locked / Unlocked:		Organisation Name:	RWE npower		
Date Created:	Tue 27/09/2005 15:50	Date Completed:	Thu 02/02/2006 12:08		
Organisation Type:	Business Sector	Registered as:	Main Company		
Subsidiaries registered:	No	Operating Scope:	UK & Overseas		
Company Type:	Plc	Financial Indices:	FTSE 250,		
Industrial Sector Classification:	Electricity	Industrial Sub-Sector Classification:	Electricity		
Employees:	10,000 - 19,999	Contract Employees:	250 - 499		
Company CHaSPI information					
Verified By:	Employee rep, Lisa Keith and Barbara Pocock	Date Published:	02/02/2006 12:08:00		
No CHaSPI Completed:	1	Date last CHaSPI Published:	02/02/2006 12:08:00		
CHaSPI Overall Weighted Score Scale of 0 to 10 (10 = excellent)	7.3	Sickness Absence Indicator Injury Indicator Serious Incidents Indicator			
Comparative Selection Average	6.8				
Number complete in selection:	23				
#	Indicators	CHaSPI Score Includes	Rating (0-10)	Weighting	Weighted Rating
1	Health and Safety Management Rating		9.4	0.33	3.1
2	Occupational Health Rating		9.6	0.17	1.6
3	Injury Rating – Employees / Contractors		6.3	0.17	1.1
4	Serious Incident Rating		3.4	0.17	0.6
5	Employee Sickness Absence Rating		5.9	0.17	1.0
	Overall Rating		-	-	7.3
6	'Under Watch' Flag				No
7	Conduct of Highly Regulated Activities				Yes
8	Directors' Declaration				Yes
9	Corporate Health and Safety Performance Index (CHaSPI) Verification				Yes
#	Additional Notes Relating to Indicators (if appropriate)				
1.10	Recognised / Formal Management Systems in Place:	Management system follows HSG 65			
7.1	Conduct of highly regulated activities:	Offshore safety case regulations			
9.1	Performance Index verification:	Employee rep, Lisa Keith and Barbara Pocock			

Figure 4 CHaSPI information for RWE npower

INTERNAL CONTROLS

The board should ensure that OHS risks are managed and controlled adequately and that a framework to ensure compliance with the core standards is established. It is important that the governance structures enable management systems, actions and levels of performance to be challenged. This process should utilise, where possible, existing internal control and audit structures and be reviewed by the Audit Committee.

The board needs to ensure that OHS risks are managed and controlled adequately and that a framework to ensure compliance is established - commensurate with the Combined Code (5) requirement to 'maintain a sound system of internal control' (Principle D.2).

Furthermore principle D.2.1 states that 'The directors should, at least annually, conduct a review of the effectiveness of the group's system of internal control and should report to shareholders that they have done so. The review should cover all controls, including financial, operational and compliance controls and risk management.' In the supporting Appendix the code says that 'significant risks, requiring assessment, may for example, include those related to.....health, safety and environmental issues.'

It is thus best practice to utilise the existing **internal control structures** for the identification and management of key OHS risks, incorporating them within the broader corporate risk register.

It is also important that a 'challenge function' exists within the system to avoid 'group think' and mere rubber stamping of management decisions and actions. This role could be played by a non-executive director or an external advisor, or even the OHS professional within the business. In the latter case we have seen it work most effectively when they have a direct line to the Chairman of the company, thus bypassing senior executives. Interestingly one of the recommendations of the King's Cross fire investigation (25) was the appointing of a non-executive director with special responsibility for safety and a direct access to the chair to provide the necessary checks and balances. Only in one case did we observe a specific role having been identified for a non-executive director (NED), where they had been appointed as the nominated H&S director with the relevant experience to perform the role.

Although such a whistle blowing system (direct access to the Chairman) has pros and cons, and in the cases found it had never been exercised to its fullest extent, it was however indicative of the 'open and transparent' approach to safety management that was evident in most organisations interviewed.

Key to the process is an effective system of OHS risk identification and management and an adequate audit/monitoring programme to ensure compliance with policies and standards. The **internal audit process** and the work of the **Audit Committee** can have a significant role to play here.

A number of examples of audit best practice were found during the research, including one system within a major oil company, where they audited against the fixed safeguards (or barriers) which are designed to prevent accidents, rather than to audit against compliance with management system procedures.

Whatever the controls, they must extend as far as necessary to discharge the directors' duties and to provide sufficient information to hold the management accountable.

Further assistance on aligning OHS with internal control can be found in '*Rewarding Virtue: Effective Board Action on Corporate Responsibility*' (6).

One transport company interviewed had an extremely detailed performance review and audit system in place across the business involving hundreds of key performance requirements.

The safety audit schedule was planned out annually to cover the key issues for the business and to capture the scope of business operations. The reports were considered both by the risk review group (effectively a board risk committee) and by the Health, Safety, Quality and Environment (HSQE) committee, who also monitored the time taken to implement appropriate corrective actions. In addition an HSQE performance report is produced on a monthly basis which runs to some 80 pages, covering all key safety issues for the business.

ORGANISATIONAL STRUCTURES

The board needs to integrate the OHS governance process into the main corporate governance structures within the business, including the activities of the main board and its sub-committees, including risk, remuneration and audit. In some cases, the creation of an additional board sub-committee to consider OHS (and/or Risk/Corporate Responsibility) may be relevant.

The view was expressed repeatedly that directors should operate collectively on OHS and that OHS was an issue for the whole board and not just for the nominated OHS director or manager. Having said that, there were a number of H&S Directors who saw their roles not as a means of total delegation from the board, but as a useful tool to help manage the day to day interactions with the professionals within the business.

In the best cases, the OHS governance process had been carefully thought through and its' implementation integrated into the key governance structures within the business, such as the activities of the risk, remuneration and audit committees.

Where OHS was considered sufficiently material to the business, we also observed a number of separate board sub-committees being established – such as a risk and/or corporate responsibility committee, or even a dedicated health and safety committee.

In addition, direct OHS experience may be taken into account in the selection of both non-executive and executive directors. However, our investigations have revealed that this is not usually the case. Selection processes have more frequently focussed on operational experience, which may indirectly provide an OHS understanding especially in high hazard areas.

Delegation of responsibility for OHS matters should be seen as identical to the delegation process for any other key management function within the business, such as financial operations. The delegation has to be done in a very formal way establishing boundaries in which the delegation will operate and a monitoring, targeting and reporting function for each of the subsidiary units – exactly as you would do for financial performance. The example below illustrates how the delegation process works within Severn Trent:

Severn Trent has incorporated OHS into all existing corporate governance structures within the organisation. The risk, audit and remuneration committees all have a role to play, in addition to a Group H&S Executive committee (which reports to the Board) comprising the CEO and all the MDs of the subsidiary businesses. Each year a number of OHS audit metrics are included in the Internal Audit programme based on key aspects of the implementation of OHS policy and the OHS risk matrix identified for the group.

The backbone of Severn Trent's H&S policy is a Safety Management System running through every tier of the company. At group level, they have developed a set of protocols, mapped to the OHSAS 18001 standard, which set out the group requirements on health and safety. Underpinning these is a set of detailed standards that cover all key risk areas relating to their businesses. Business units are subject to regular audits against these standards. They use the HSE's Climate Survey tool to monitor performance and benchmark results against other companies.

Every year, business units are set challenging targets on health and safety performance, and the managing directors' bonuses are strongly tied to achievement of these targets. The targets take two forms – an improvement in measures such as Reporting of Injuries, Diseases and Dangerous Occurrences Regulations (RIDDOR) Reportable Incident Rates, and the achievement of high scores at a specified number of locations in the British Safety Council Five Star Audit Scheme.

British Airways has established a separate Safety Review Committee, which is a formal sub-committee of the main board. The Committee comprises three board members nominated by the Nominations Committee, who have ultimate responsibility for safety performance review across the business. They provide the 'challenge function' for the business and have the ability to seek external advice on safety matters in order to discharge their duties adequately.

The key message is that the board should organise itself to deliver OHS governance, where the actual process is considered and thought through and the appropriate structures are put in place to make it happen.

10. BEST- PRACTICE PRINCIPLES

In summary, we found the key elements of good practice in OHS Governance are reflected by the seven key principles outlined below:

BEST- PRACTICE PRINCIPLES FOR OHS GOVERNANCE

Director competence

All directors should have a clear understanding of the key OHS issues for their business and be continually developing their skills and knowledge.

Director roles and responsibilities

All directors should understand their legal responsibilities and their role in governing OHS matters for their business. Their roles should be supported by formal individual terms of reference, covering as a minimum setting OHS policy and strategy development, setting standards, performance monitoring and internal control.

At least one nominated director (which could be the Chairman or preferably one of the independent non-executive directors, where they exist) should have the additional role of overseeing and challenging the OHS governance process.

Culture, standards & values

The board of directors should take ownership for key OHS issues and be ambassadors for good OHS performance within the business, upholding core values and standards. They should set the right tone at the top and establish an open culture across the organisation with a high level of communication both internally and externally on OHS issues.

Strategic implications

The board should be responsible for driving the OHS agenda, understanding the risks and opportunities associated with OHS matters and any market pressures which might compromise the values and standards, and ultimately establishing a strategy to respond.

Performance management

The board should set out the key objectives and targets for OHS management and create an incentive structure for senior executives which drives good OHS performance, balancing both leading and lagging indicators and capturing both tangible and intangible factors. Non-executives (through the Remuneration Committee, where one exists) should be involved in establishing the appropriate incentive schemes.

Internal controls

The board should ensure that OHS risks are managed and controlled adequately and that a framework to ensure compliance with the core standards is established. It is important that the governance structures enable management systems, actions and levels of performance to be challenged. This process should utilise, where possible, existing internal control and audit structures and be reviewed by the audit committee.

Organisational structures

The board should integrate the OHS governance process into the main corporate governance structures within the business, including the activities of the main board and its sub-committees, including risk, remuneration and audit. In some cases, the creation of an additional board sub-committee to consider OHS (and/or Risk/Corporate Responsibility) may be relevant.

11. RELEVANCE OF THIS FRAMEWORK FOR SMALL AND MEDIUM SIZED AND PUBLIC SECTOR ORGANISATIONS

SMEs do not operate within the same kind of management and governance structures as large companies and corporations, neither do public sector or not-for-profit bodies. However, all organisations, large or small, tend to have a governing body consisting of two or more directors together with others from within or external to the operation.

All the seven best practice principles have resonance for SMEs, public sector bodies and other organisations alike. Obviously, the use of non-executives and particular board sub-committees may not be relevant, but the actual functions these 'units' are expected to form are definitely relevant – such as to challenge the OHS governing system.

For any organisation, it is imperative that the directors of the operation have a fundamental competence in relevant OHS matters and that they understand their role in governing OHS, particularly in relation to their legal responsibilities as an employer. In smaller organisations, the attitude of directors is even more important in establishing the right culture to ensure effective OHS performance. The directors should institute fit for purpose organisational structures to govern and manage OHS for their organisation and set targets within an appropriate strategic framework. Finally, they will always need to ensure the appropriate controls are in place to ensure as a minimum legal compliance.

12. FINAL RECOMMENDATIONS

The existing HSC guidance on directors' responsibilities for OHS no longer reflects best-practice governance in large UK companies and is in need of updating. The distinction between the role of executive managerial responsibilities and the governance role of the board of directors is not clear – even though some directors may be performing both functions.

The findings of this initial study suggest that there would be strong support among a number of stakeholders for re-visiting and re-issuing the guidance and including specific elements of the findings of this report on the emerging best practice in OHS governance. Indeed, one of the most consistently expressed views from the directors interviewed was that there was (a) sufficient regulation controlling OHS in the workplace and enabling prosecution of directors should things go wrong and (b) an urgent need for improved advice and guidance (and even support) from the regulators to enable directors to take better control of OHS within their organisations.

Such guidance must be written in a vocabulary that directors will understand; cover the issues that really matter and put the guidance in the language of the board: the language of risk, opportunity, efficiency, market vision and shareholder value – the language of corporate governance. The principles defined above together with the examples given in the main body of the text could provide a sound basis for future development of a director's guidance document on OHS governance (to replace INDG343), which is recommended.

APPENDICES

APPENDIX A: LIST OF CONSULTEES

Table 1 List of consultees

<i>Companies/Corporations:</i>	<i>People Consulted:</i>
Argos Retail Group	Glynn Roberts, Member CR Steering group and Group CR Advisor
Astra Zeneca	Graeme Collinson, Head of UK Safety, Health and Environment
Babcock International	Bill Williamson, MD Port & Property Services Andy Forbes, Health, Safety, Environment and Security (HSES) manager
BHP Billiton	David Slater, Member of the Health, Safety and Environment Committee of the Board
BT	Dave Wallington, Group Safety Advisor David McFarlane, Divisional Risk ,Safety Quality manager
Centrica	Andrew McCallum, Corporate Responsibility Manager* Judy Greevy, Head of Corporate Responsibility and Diversity*
GUS plc	Sarah Sodeau, Group Head of Risk Assurance and CR Gordon Bentley, Company Secretary Simon Hodgson, CSR Advisor
Hilton Group plc	Mike Noble, Group Company Secretary
Hilton International (now subsidiary of Hilton Hotels Corporation)	Robert Kennedy, Vice-President Technical Services Douglas Cameron, Director of Safety and Security Risk
Ladbrokes plc	Ros Barker, Executive Director of Human Resources Chris Cerroni, Head of Health and Safety and Security Bill Bennett, Health and Safety (H&S) Manager
Marathon Oil	Don Mackenzie, Health, Safety and Environment (HSE) manager
National Grid Group	Gareth Llewellyn, Group CR Director* Steven Petit, Non-Executive Director*
National Semiconductors	Bob Steel HSE manager
O2	John Lyons, Head of Health and Safety Charlotte Wolffe, Head of CR Philip Bramwell, Company Secretary*
Persimmon	David Bryant, Southern Region Chairman and Director Steve Acaster, Head of Health and Safety
Royal Bank of Scotland	Jim Murray, Head of Group Health and Safety
Scottish Media Group	Hazel MacGough, Director of Human Resources (and H&S) George Boag, HSE Manager

* Interviewed by Acona in conjunction with broader CR Governance Project (6)

<i>Companies/Corporations (continued):</i>	<i>People Consulted:</i>
Scottish Power	George Kirk, Group HSE Director Ron Hunter, Director Power Generation Division
Severn Trent	Elaine White, Health and Safety Manager
Shell	Kathy Lee Love, Barrister and Senior Legal Counsel, Oil Products
Talisman Energy	Dick Bridger, HSE Manager
Tubelines	Martin Brown, Director of HSE
V Ships	Capt. Bob Bishop, CEO ship management David McFarlane, Divisional Risk ,Safety Quality manager
<i>Government Departments:</i>	<i>People Consulted:</i>
HSC	Bill Callaghan, Chair of the Commission
HSE	Neal Stone, Chair's Office Jonathan Russell, Deputy Director, Cross Cutting Interventions Division Alan Morley, Business Involvement Programme Paul Kloss, Business Involvement Programme
DTI	Stephen Spivey, Director of Corporate Governance
<i>Investors:</i>	<i>People Consulted:</i>
Henderson Global Investors	Rob Lake, Head of Corporate Engagement
Jupiter Asset Management	Simon Abrams, Senior Analyst
Insight Investment	Steve Waygood, Director, Investor Responsibility
<i>Others:</i>	<i>People Consulted:</i>
TUC	Tom Powdrill, TUC Institutional Investment Officer
Glasgow University	Anton Muscatelli, Prof of Economics
Salford University	Frank Wright, Professor of Law

APPENDIX B: ADDITIONAL OCCUPATIONAL HEALTH AND SAFETY GUIDANCE FOR DIRECTORS

So what other guidance is out there already to assist directors in **governing** health and safety matters? Other than guidance from RoSPA and the Institute of Directors (IoD), which is highlighted below, the research has found very little.

The majority of the guidance available on OHS – and the associated legislative structures – is focussed on the practitioner – the professional with the expert knowledge on risk assessments, the procedures and audits – even the debates on tolerability.

Most company directors are not OHS professionals and first hand experience suggests that the sheer volume of information and technical analysis often leaves them wondering where to start. An understandable response to this might be a ritual acknowledgment of the importance of the topic, followed by almost complete delegation to the OHS professional within their organisation. Indeed, 21% of large public, private and voluntary sector organisations^{††} do not direct OHS at board level, of which 1 in 20 cite the reason for delegation as the perception that OHS is not a matter for directors (2). A number of UK directors therefore seem to take the view that their involvement begins and ends by employing someone to ‘do’ H&S for them.

Such forms of delegation (without any engagement at the highest levels) are missed opportunities for the business – avoiding the returns that good OHS leadership brings (eg reduced costs, improved staff morale etc). Furthermore, it is contrary to basic corporate governance standards. Rather than understanding the issues, leading the debate and managing the risks, the board is working on blind faith in the hope that all will be well. All of which goes against the spirit of the Combined Code.

ROSPA

ROSPA suggest (34) that the lack of engagement by directors in the OHS issue may be because many directors, particularly those in smaller firms, have not fully understood or responded to contemporary OHS concepts:

For example, they may:

- Perceive OHS as a technical and regulatory compliance issue but fail to understand the goal setting approach to OHS law;
- See health and safety requirements as over-restrictive or ‘burdensome’ and wrongly interpret HSC/E guidance as having prescriptive regulatory force; and
- See regulations as being too vague and/or impossible to comply with and fail to fully appreciate the ‘business case’ for OHS.

In 2001, ROSPA instituted the Director Action on Safety and Health (DASH) initiative which was effectively a loose consortium of organisations (mainly government, regulators and academic institutions) concerned with director involvement in health and safety. Its general aim was to address the specific and distinct OHS role of directors, including those directors at board level who may be charged with oversight of health and safety matters – and specifically what is needed to enable them to initiate and drive effective risk management in their organisations.

Despite establishing DASH as a key action point – they haven’t yet underlined the specific roles of directors in leading OHS – rather ROSPA has to date explored corporate target setting (35) and encouraging greater external reporting on OHS (36).

^{††} Despite the fact that the number of large organisations who report that health and safety is directed at a board level has risen from 58% in 2001 to 66% in 2003 and 79% in 2005 – taken from page 13, reference 2.

INSTITUTE OF DIRECTORS

The IoD has developed two short Directors Briefing notes that cover Health and Safety and H&S Risk Assessments (37). This is the closest we get to guidance on specific director responsibilities, but these notes confine themselves to the legal minimums required of directors under the Health and Safety at Work Act 1974 etc., rather than exploring the whole issue of roles, leadership and governance.

OTHER SOURCES

A number of trade associations have set up working groups that produce good information and benchmarking, but, again, tend to focus on the practitioner rather than the director.

Many other sources of guidance can be found in a number of other, less obvious, documents that a director might usefully read. However, it is unlikely that they currently will engage with the topic at this level of detail.

OTHER SOURCES OF GUIDANCE:

Revitalising Health and Safety Strategy document, DETR and HSC, June 2000 (1). See www.hse.gov.uk/revitalising/strategy.pdf

Successful Health and Safety Management, HSG 65, HSE Books 1997 ISBN 0 7176 1276 (28)

Leadership for the Major Hazards Industries, INDG 277, HSE Books 1998
www.hse.gov.uk/pubns/indg277.pdf

Best practice case studies in H&S Leadership (29). See www.hse.gov.uk/corporateresponsibility/casestudies

Institute of Directors' Briefing Notes LA3 'Health and Safety' and LA4 'Health and Safety Risk Assessment'

Reducing risks, protecting people, HSE's decision making process, HSE 2001 (38)

Health and safety in annual reports: Guidance from the HSC (39). See www.hse.gov.uk/revital/annual.htm

HSE Corporate Health and Safety Performance Index (CHaSPI) (40). See <http://www.chaspi.info-exchange.com/>

Managing health and safety, INDG 275, HSE Books 1998 (41)
www.hse.gov.uk/pubns/indg275.pdf

Questioning performance – the director's essential guide to health, safety and the environment by David Eves and Rt Hon John Gummer. ISBN 0 901357 37 5, IOSH publication 2005,
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- (10) *Corporate Manslaughter: The Government's Draft Bill for Reform* Cm 6497, Home Office, March 2005
- (11) *Statutory Instrument (S.I. 2005/1011)* amending part 7 of the Companies Act (1985) on accounting and audit, 22 March 2005
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- (13) *RR134*, www.hse.gov.uk/research/rrpdf/rr134.pdf and *RR338*, www.hse.gov.uk/research/rrpdf/rr338.pdf
- (14) see www.hermes.co.uk
- (15) see www.barclaysglobal.com
- (16) *Health and Safety Indicators for Institutional Investor*, Claros Consulting, HSE Publications Feb 2002
- (17) see <http://www.chaspi.info-exchange.com/>
- (18) *Insight Investor Responsibility Bulletin* Summer 2004, Autumn 2004, Spring 2005, www.insightinvestment.com.
- (19) *Getting What You Pay For: Linking Executive Remuneration to Responsible Long-Term Corporate Success* Henderson Global Investors www.henderson.com
- (20) *Less Stress, More Value, Henderson's 2005 Survey of Leading UK Employers* Henderson Global Investors www.henderson.com
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- (40) *HSE Corporate Health and Safety Performance Index (CHaSPI)* <http://www.chaspi.info-exchange.com/>
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