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# Briefing

## Corporate Governance in the Private and Public Sectors



INSTITUTE OF DIRECTORS  
IN IRELAND

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Views on what effective corporate governance should deliver can differ according to whether an entity is in the private or the public sector. However, there are more similarities than distinctions.

The principal objectives in the private sector are often said to be to (a) directly enhance shareholder value and (b) provide an assurance that shareholder value is being enhanced. However, the principal objectives of corporate governance in the public sector (commercial or non-commercial) may initially appear to be different: ensuring that the entity provides the relevant service or product to citizens and residents effectively, efficiently and ethically.

Nonetheless, there is common ground: all corporate governance should be focussed on the interests of "stakeholders" (those with a legitimate interest in the entity albeit not necessarily having any formal ownership role in it). Of course, who the stakeholders are may differ from one type of entity to another: the shareholders in a private company, taxpayers in the case of a public body, perhaps employees in a body of either type, welfare recipients in the case of some public bodies, and so forth. Increasingly, there can be a public stakeholder element to financial services, especially in the case of systemically important institutions.

In reality, often these seemingly diverse constituencies have many shared interests (not necessarily profit-maximisation in the private sector) and common means of meeting their needs. For example, even in the private sector sustainability is as important as profitability and the need to protect reputation and brand can promote the importance of ethical behaviour, a consideration that is central in corporate governance in the public sector.

In the 2018 edition of the "UK Corporate Governance Code" (the "Code") the Financial Reporting Council has suggested that the purpose of corporate governance (in a listed company) is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term sustainable success of the company generating value for shareholders and contributing to wider society. A minister could reasonably be satisfied if even a non-commercial State body were to adopt the same approach, the measure of "long-term success" (and its metrics) of course being different in either case.

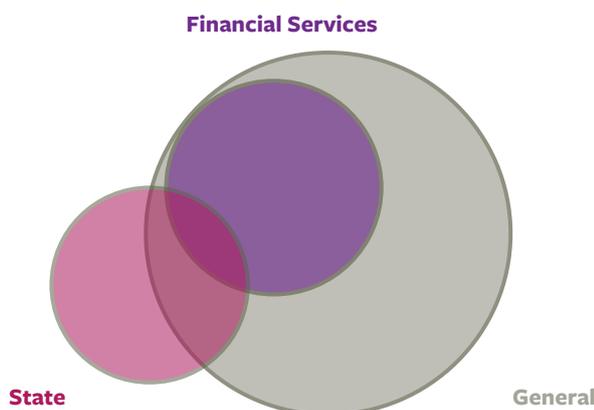
The objective of this briefing is to identify the common themes and objectives that cut across the numerous sources of corporate governance requirements and statements of good practice, both generally and specifically in the financial services and State sectors, and to help directors to translate principles into practice.

This briefing does not list ‘boxes to be ticked’. Rather, we address what we have, in advising clients, noticed are common and recurring considerations that, irrespective of whether an entity is in the private or the public sector, we believe enhance its ability to achieve its objectives.

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## The Corporate Governance Landscape

This factsheet addresses general corporate governance considerations (applying in the private and public sectors) and then specifically those that are relevant to financial



There now is a huge array of corporate governance “codes”, “recommendations”, “guidelines”, “principles” and so forth, some of which are general and others of which are sector-specific. However, while this is a crowded market, we suggest that there are two key differentiators: whether compliance with a particular code or provision is (a) mandatory and / or (b) sensible or prudent.

Also, the content of many codes overlaps and, in reality, few of them offer much that is new or innovative. The Code is rightly regarded as having set the standard for corporate governance not merely in the case of companies listed on the London Stock Exchange (or, with amendments, Euronext Dublin (formerly the Irish Stock Exchange)) but generally in the private sector. The 2015 editions of the Central Bank of Ireland’s Corporate Governance Requirements for Credit Institutions and, separately Insurance Undertakings<sup>1</sup> (the “CBI Codes”) do not refer to the Code but is heavily influenced by it. The same can be said of the 2016 edition of the “Code of Practice for the Governance of State Bodies” as amended (the “State Code”) which is maintained by the Minister for Public Expenditure and Reform.

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<sup>1</sup> Similar requirements exist for certain other regulated financial services entities.

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## Common Themes and Issues

Irrespective of the relevant source, corporate governance principles tend to divide into two categories:

- the general, for which tangible metrics can be difficult to identify and the assessment of compliance with which tends to be intuitive rather than scientific or arithmetical; and
- the specific, for which tangible metrics are available.

The specific requirements tend to be straightforward and easily measured, such as whether a board or committee has met the minimum number of times that is prescribed. However, this briefing is more concerned with the less tangible requirements.

### *‘Motherhood and Apple Pie’?*

It is worth recalling the general themes of the Code: leadership, effectiveness, accountability, remuneration and relations with shareholders. The tone is set from the top:

“A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society.” (Principle A)

“There should be a clear division of responsibilities between the leadership of the board and the executive leadership of the company’s business.” (part of Principle G)

“The chair leads the board and is responsible for its overall effectiveness in directing the company. They should demonstrate objective judgement throughout their tenure and promote a culture of openness and debate. In addition, the chair facilitates constructive board relations and the effective contribution of all non-executive directors, and ensures that directors receive accurate, timely and clear information.” (Principle F)

“In order for the company to meet its responsibilities to shareholders and stakeholders, the board should ensure effective engagement with, and encourage participation from, these parties.” (Principle D)

“Non-executive directors should have sufficient time to meet their board responsibilities. They should provide constructive challenge, strategic guidance, offer specialist advice and hold management to account.” (Principle H)<sup>2</sup>

While these principles are general rather than specific or measurable, they are critical, both at the level of practice and in terms of culture, themes that we will explore further later.

Assuming that the board of a company or State body is familiar with the general principles of the Code, the CBI Codes and / or the State Code (as relevant), the following considerations (not in any order of priority) have struck us as making an especially valuable contribution to effective corporate governance. This is in the context of the well-established distinction that should exist between the responsibility of the company’s executive for the management of the company’s business and the responsibility of the board for the governance of the company. In this regard, clear divisions of responsibility, and of matters that are reserved to the board, are critical.

The following considerations are necessarily selective but are prompted by our experience in working with client companies and other entities in a range of sectors.

- **Legal and fiduciary duties:** A director of a company and of a statutory corporation owes fiduciary duties, and a large number of specific statutory duties, to the relevant entity.
- **Education and briefing of board members:** Well-briefed board members are essential to the efficient and effective governance of any entity. Such briefing should relate not merely to the business of the entity but also to the legal and regulatory environment in which it is operating. This is a requirement in the **case of a State body**<sup>3</sup>. Such briefings should be an on-going rather than a once-off exercise, commencing with an induction programme for new board members based on a board handbook.
- **Non-executive directors / board members (independent):** We consider further below the significance of the role of a non-executive director generally and of an independent non-executive director (an “INED”) in particular. Tests of independence vary although a common approach is emerging in legislation such as Companies Act 2014 (as amended to incorporate the EU Statutory Audit Regulations). INEDS bring a hugely important independent judgement to decisions that otherwise might be affected by vested interests or ‘group think’. The role of INEDS, or at least non-executive directors, on an organisation’s audit committee (if any) can be critical. Under Revenue Commissioner rules, every director of a registered charity must be non-executive which leads to its own corporate governance dynamics and considerations.
- **Role of the chair:** The personality and style of the chair of the relevant board
  - whether inclusive, whether probing and challenging, whether deferential to management or independent-minded
  - are significant influences on the corporate governance of an entity.
- **Internal audit:** An internal audit function performs quite a different role to that of the external auditor. While an external (statutory) auditor is concerned with whether the books of account give a true and fair view of the company’s state of affairs, the role of an internal audit function is much wider and should take a ‘whole of business’ approach, reporting directly to, or at least having unfettered access to, the chair of the company and the audit committee.

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3 Minister for Public Expenditure and Reform (2016), “Code of Practice for the Governance of State Bodies”, section 3.7

- **Legal adviser (internal or external):** Although different considerations and dynamics may sometimes apply in the respective roles of in-house counsel and external counsel, the professional objectivity and independent-mindedness of a lawyer, by nature and by training, and expertise in law and regulatory matters, can be important contributions to the blend of influences that achieve a high standard of corporate governance in an organisation.
- **Compliance and risk function:** Loosely related (and in some companies linked) to the internal audit function, it has come to be recognised in the past decade that legal and regulatory compliance, and thorough understanding and awareness of risks (of all varieties), are fundamental to the ability of an organisation to manage itself and seek to achieve its objectives.
- **Audit committee:** Where it has been established, an audit committee (necessarily populated by non-executive directors or INEDs), as a committee of the main board, is a valuable forum for consideration and exploration of an entity's financial compliance, perhaps (in a smaller entity) combining this role with that of risk monitoring and management.
- **Whistle-blowing arrangements:** Reflected now in the Protected Disclosures Act 2014 but previously in many sector-specific or limited- scope enactments, 'whistle-blowing' protections have together been seen to be an important 'safety valve' for concerns and potential problems that otherwise would be unrecognised by an organisation. There also are whistle- blowing obligations.<sup>4</sup>

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## State Bodies

Special considerations apply in the case of a State body, subject as it is to the State Code for the protection of the interests of its stakeholders (taxpayers and service-users). Corporate governance in a public sector entity is a part of the matrix of controls that are intended to ensure that, ultimately, all public functions and all public expenditure can be traced, in a line of accountability, back through a minister to the Houses of the Oireachtas.

Therefore, such a body is subject to rules and requirements that do not necessarily apply to an entity in the private sector, such as procurement rules, provisions regarding worker participation in the particular board and the Standards in Public Office and Ethics in Public Office legislation<sup>5</sup>. The State Code is only part of the picture. Nonetheless, we reiterate that, as highlighted above in the diagram, many of the same corporate governance principles apply in the case of a State body as apply in the case of a private sector entity.

In the UK a number of guiding principles have been identified for those holding public office (the "Nolan Principles")<sup>6</sup> and which are helpful in highlighting the slightly different set of considerations that applies compared with the private sector.

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4 Eg Criminal Justice Act 2011, section 19; Central Bank (Supervision and Enforcement) Act 2013, section 38(2) (see below).

5 Such as the Standards in Public Office Commission (2003), "Code of Conduct for Office Holders".

6 (UK) Committee on Standards in Public Life (1995), First Report.

These are echoed in the codes maintained by the Standards in Public Office Commission :

- **Selflessness:** Holders of public office should act solely in terms of the public interest.
- **Integrity:** Holders of public office must avoid placing themselves under any obligation to people or organisations that might try inappropriately to influence them in their work. They should not act or take decisions in order to gain financial or other material benefits for themselves, their family, or their friends. They must declare and resolve any interests and relationships
- **Objectivity:** Holders of public office must act and take decisions impartially, fairly and on merit, using the best evidence and without
- **Accountability:** Holders of public office are accountable to the public for their decisions and actions and must submit themselves to the scrutiny necessary to ensure this.
- **Openness:** Holders of public office should act and take decisions in an open and transparent manner. Information should not be withheld from the public unless there are clear and lawful reasons for so doing.
- **Honesty:** Holders of public office should be truthful.
- **Leadership:** Holders of public office should exhibit these principles in their own behaviour. They should actively promote and robustly support the principles and be willing to challenge poor behaviour wherever it occurs.

As said, these principles are evident in the Irish legislation and codes also, compliance with the spirit of which is regarded as being as important as compliance with the letter. Although the State Code does not have legal effect, it seems likely that a breach of the State Code might motivate the relevant minister, the Comptroller and Auditor-General and the Public Accounts Committee of Dáil Éireann to consider the role of the relevant board in terms of that breach.

The requirements of the State Code apply to every State body and every subsidiary of a State body, although a State body or a subsidiary may request a complete waiver or a partial amendment in view of particular circumstances applying to it.

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## Financial Services Sector

In this section we concentrate on those elements of good corporate governance (and the CBI Codes in particular) for which metrics are not obvious. Although not of specific application to all regulated financial services firms or indeed non-regulated firms, many of the broad concepts and objectives articulated in the CBI Codes are illustrative of best practice, in the same way as the Code is regarded as best practice for companies generally and not merely listed entities.

The Central Bank expects that a relevant institution has and applies minimum core standards to ensure an appropriate and robust corporate governance framework consistent with both the risks and nature of the relevant institution.

This means that there should be procedures, processes and internal attitudes controlling and directing the institution which are reflected in a clear allocation of roles, authorities, responsibilities. The requirements are intended to promote strong and effective governance and sound and effective risk management.

Clearly there is an expectation that formalised written policies and procedures are drawn up and approved. Frequently, so much work is undertaken to complete the documentation exercise that the written document may not accurately reflect the commercial realities. An obvious source of serious concern would be to have written policies and procedures that are not adhered to in practice.

### **Who should be on a board?**

An institution’s corporate governance structure must be sufficiently sophisticated to ensure effective oversight of the specific activities it carries on. The importance of having a board that is of appropriate size and expertise to adequately oversee its operations is obvious. In recent times there has been increased emphasis on gender balance, diversity and inclusion on boards of companies (the State Code was amended in September 2020 to specifically include an annex on this topic.)

From the perspective of both (i) the individuals acting as directors (given the risks they now assume), and (ii) the Central Bank, the level of expertise that is demanded, the obligations that are imposed and the risks of something going wrong are significant. The culture is also relevant:

“An effective board should not necessarily be a comfortable place. Challenge, as well as teamwork, is an essential feature. Diversity in board composition is an important driver of a board’s effectiveness, creating a breadth of perspective among directors, and breaking down a tendency towards ‘group think’.”<sup>7</sup>

The role of the board is to act critically and independently of management to exercise objective and effective judgement in respect of the business strategy, risk management and legal and regulatory compliance of the institution – this is a function that can only be discharged properly by individuals who understand fully, and can meet, the standards that are required of them.

The CBI Codes suggest that the role of the board is to be responsible for the effective, prudent and ethical oversight of the institution and to this end it should be setting and overseeing, among other things:

- business strategy for the institution;
- strategy for the on-going management of material risks; and
- an adequate and effective internal control framework, that includes well-functioning risk management, compliance and internal audit functions as well as an appropriate financial reporting and accounting framework.

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7 Financial Reporting Council (2011), “Guidance on Board Effectiveness”, paragraph 1.3.

### ***The role of independent and other non- executive directors***

Often INEDs are said to be the first line of defence in ensuring the probity of regulated entities. The expectation is that, by having the ability to exercise sound judgement and decision-making independent of the views of management, political interests and other inappropriate outside interests, an INED will bring an independent viewpoint to the deliberations of the board, challenging the executive team.

Non-executive directors (both independent and otherwise) are generally expected to:

- ensure that there is an effective executive team in place;
- participate actively in constructively challenging and developing strategies proposed by the executive team;
- ensure that in no sense is the board simply ‘rubber-stamping’ strategies that are proposed by management;
- participate actively in decision-making;
- and exercise appropriate oversight over execution by the executive team of agreed strategies, goals and objectives and monitor reporting of performance.

Ideally all senior executive management teams will:

- understand the institution’s business strategy, set by the board;
- conduct business in a prudent and ethical manner; and
- ensure the recognition and appropriate discharge of risk and compliance issues.

Although not quite a ‘whistleblower’s charter’, the CBI Codes reflect many circumstances in which the board must report directly issues to the Central Bank and which circumstances are not necessarily aligned with the interests of the institution, its board or shareholders. This is reinforced by the new statutory obligation on persons performing pre-approval controlled functions to proactively ‘blow the whistle’ if they suspect a breach of financial services legislation by their company.<sup>8</sup>

Generally the Central Bank expects ‘full and frank’ communication so perhaps the specific provisions in the CBI Codes are merely expressing what the Central Bank would expect to be the normal course of business.

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## **Key Message**

In our experience, notwithstanding the bewildering array of materials that exist on the topic, the key drivers of effective corporate governance in any sector – private (financial services or otherwise) or public – are education and thorough briefing of board members, the personality and style of the chair of the relevant board, the role and contributions of well-briefed INEDs, an active and well-resourced internal audit function and the integration of legal advice in the decision-making process. While the many codes variously require and /or recommend much more besides, in our view these aspects of the governance of an entity contribute disproportionately beneficially to effective corporate governance.

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<sup>8</sup> Central Bank (Supervision and Enforcement) Act 2013, section 38(2)

***Alternatively, your usual contact in McCann FitzGerald will be happy to help you further.***



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