DIRECTOR'S SIGNPOST

YOUR GUIDE TO DIRECTORSHIP

With contributions from twelve company directors

AUSTRALIAN INSTITUTE
of COMPANY DIRECTORS

DIRECTOR'S SIGNPOST

The Australian Institute of Company Directors is a member institute for directors dedicated to having a positive influence on the economy and society by promoting professional directorship and good governance. Company Directors delivers director development programs, information and advocacy to enrich the capabilities of directors, influence the corporate governance environment in Australia and promote understanding of, and respect for, the role of directors. With offices in each state of Australia and more than 30,000 members, Company Directors represents a diverse range of organisations from the top ASX 200 publicly listed companies to not-for-profits, public sector entities and private companies.

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Level 30, 20 Bond Street
Sydney NSW 2000
T: 61 2 8248 6600
F: 61 2 8248 6633
E: publications@companydirectors.com.au
W: www.companydirectors.com.au

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We thank all contributors:

Elizabeth Carr FAICD
Director of WorkCover Authority NSW, Workers Compensation Investment Fund (NSW), Environmental Protection Authority (WA), St Mary's Anglican Girls' School, the Kokoda Track Foundation, Kambala Girls' School. Chairman of the Macular Degeneration Foundation.

Michelene Collopy GAICD
Director of Teachers Mutual Bank and Perpetual Superannuation Limited. Council member of the University of Technology Sydney.

Ewen Crouch FAICD
Chairman of Partners at Allens. Chairman of Mission Australia. Director of Sydney Symphony Orchestra.

Michael Dilettoso GAICD
Director of the Spastic Centres of South Australia, Meridien Investments Pty Ltd, E Property Group Pty Ltd. Chairman of SA Angels Inc. Member of Australian Institute of Company Directors' Emerging Directors Committee.

Dr Stephen Judd GAICD
Director of the Community Council for Australia and Aged Care Services Association NSW and a member of the Minister's Dementia Advisory Group. Chief Executive Officer of HammondCare.

Marina Go MAICD
Director of Netball Australia and member of the Sydney Symphony Vanguard Committee. Publisher at Private Media.

Alexandra Green GAICD
Director of Cerebral Palsy Alliance (CPA) and bronze medallist at the London 2012 Paralympics.

Bruce Harris
Corporate lawyer and Australian Institute of Company Directors course writer.

Lauren McLaughlin GAICD
Director of Leminscate and the Australian Interactive Media Industry Association (AIMIA).

Chris Stewart GAICD
Director of Helping Hand Aged Care, Shelter SA and member of Australian Institute of Company Director's SA/NT Council and inaugural chair of the Australian Institute of Company Directors' Emerging Directors Committee.

Janice van Reyk FAICD
Director of Melbourne Water, Port of Melbourne Corporation and Citywide.

Mr Raj Venga FAICD
Director of the Institute of Financial Services (IFS). Chief Executive Officer and Ombudsman of Credit Ombudsman Service Limited.

Richard Willson FAICD
Director of Taronga Mines Limited, Tellus Resources Limited and Unity Housing Company. Chief Financial Officer and company secretary of YTC Resources Ltd.

Introduction

If you are a new company director, or have a few years under your belt but need essential information at your fingertips, *Director's Signpost* is your starting point to the directorship and board arena.

With nearly two million companies registered with the Australian Securities and Investment Commission (ASIC) and an average of 15,000 new companies registered each month, it is clear that directorship is growing at a very swift rate. In fact, at the time of going to press there are well over three million directorships in this country.

Directorship spans a broad spectrum of entity types, from tiny start-ups to massive publicly listed national and international companies, small not-for-profit community organisations to some of this country's largest not-for-profit entities, and includes privately held companies with one director and those with many directors and worth many millions of dollars.

While there is a vast array of entity types requiring a director, under the *Corporations Act 2001*, there is effectively only one kind of directorship. All directors have the same duties and responsibilities, as well as the same rights and powers. In the boardroom, all decisions are not only made by the board as a whole, but each director is held individually responsible.

Your actions as a director are not only governed by the Corporations Act, but also at common law, under state and territory laws, and regulations from various regulatory bodies. In fact, currently an estimated 700 laws and statutes relate to directorship alone.

For instance, if you are a new director of a publicly listed company, your actions may be governed by Australian Stock Exchange (ASX) 'Listing Rules'. If you are a director on a government board, other state or federal legislation could also govern your activities.

The new Australian Charities and Not-For-Profits Commission (ACNC), established by the federal government after the 2010-2011 budget, is tasked with governance of these sectors. If you are a director of a charitable or not-for-profit organisation, your actions on its behalf could be affected by this new body.

No matter what your role as a director entails for you specifically, it is very important that you are fully aware of what laws and regulations directly affect *your* role and *your* company or organisation. Ignorance of a law is no defence, and just as importantly, good directorship means helping your organisation to grow and thrive within the legal and regulatory framework you must operate in. You may also need to seek the guidance and advice of experienced and reputable business advisors, especially those with direct knowledge of your area of business and industry.

Your duties and responsibilities, rights and powers, and a host of issues directly related to your role as a director, are outlined in Chapter 1.

Along with laws and regulations, being a successful company director and member of a board requires an understanding of corporate governance principles and practices. Many experienced directors view governance as an art as much as a science, and are of the opinion that it is a continuous learning experience.

As the governance landscape changes with new legislation, new case law, different economic environments, changing business norms, and improved directorship and board practices, good governance is an ever-evolving topic.

Understanding the principles of corporate governance will help you as a director with balancing competing demands with the systems and processes put in place to control and monitor your organisation, especially those relating to performance and risk.

Corporate governance is discussed in Chapter 2.

Being a member of a board can be a personally and professionally fulfilling role, and many non-executive directors often choose to join more than one board, often also volunteering their time to one or more not-for-profit boards.

The impact of an individual director, working in concert with their fellow board members and the organisation's management, can be far-reaching for the company, its shareholders, employees and other stakeholders, and ultimately, even for Australia's society and economy.

Board operations and related topics are covered in Chapter 3.

Professional development and directorship go hand-in-hand and there are many options for improving your skills and knowledge, as well as networks and opportunities, but they need to be actively pursued.

As directorship can often be a solo activity, simply taking the time to meet and speak with other directors is important. As a starting point for interchange, the insights and views of several directors who range from new to very experienced are included throughout this book. These directors also represent a broad spectrum of industries. We are grateful for their contribution to *Director's Signpost*.

Your professional development options are covered in Chapter 4.

Directorship can be challenging and rewarding but should include a thorough understanding of the legal framework, governance practice and board operations. We hope you will find *Director's Signpost* to be an essential part of your development and growth as a director.

Chapter One

The Company Director

Directorship basics

What is a director?

Under the *Corporations Act 2001*[1] (the Act or Corporations Act) a company has all the powers of a natural person and the exercise of those powers is delegated to the company's directors, subject to the company's constitution.

A director has a 'fiduciary'[2] relationship with the company (for more information about what constitutes a company, see page 4) and must exercise their powers and discharge their duties with due care and diligence in good faith in the best interests of the company and for a proper purpose.

A director's role can vary if he or she is an executive director or a non-executive (i.e. part-time) director. Essentially, a director takes an overview of the corporation, and the strategies to be implemented, to achieve its stated purpose.

Directors oversee management's implementation of those strategies and performance against budgets, which directors must consider and potentially approve as part of their role. Directors may delegate their powers to managers, however the *Centro* decision (see page 7) makes it clear that there are some matters that cannot be delegated, such as where the director's opinion is required, for example, in approving financial statements.

1 For more information about the *Corporations Act 2001*, visit www.comlaw.gov.au/Series/C2004A00818.
2 For definitions of terms relating to directorship, refer to this book's glossary, *The Language of Directorship*.

Who can be a director?

A director must be over the age of 18, of sound mind and capable of performing the duties associated with the role.

A director cannot be an undischarged bankrupt or have been convicted of certain offences or breaches of company law unless he or she has permission from the Australian Securities and Investment Commission (ASIC)[3] or the court.

It is an offence to be a 'shadow' director and have one or more 'dummy' directors run a company on behalf of a disqualified director.

Appointing a director

Subject to the company's constitution, a company may appoint a director by resolution passed at a general meeting or by the other directors. Where a director is the founder of a company he or she will be self-appointed.

Before being appointed, the nominee must give his or her signed consent to act as a director and the company must retain this document. The company must also lodge notice of the appointment of a new director with ASIC within 28 days; this must include the following personal details:

- given and family names
- all former given and family names
- date and place of birth
- home address.

A person who has not been officially appointed but acts as a director, or whose recommendations, instructions or wishes are generally heeded by the board, is also considered to be a director (called a 'shadow' director) unless that person is acting in a professional capacity – such as an accountant or solicitor.

The company must lodge any changes to these details as they occur and inform ASIC if a director is removed or resigns.

There is no limit to the length of time a director can sit on a board. However, the Australian Securities Exchange (ASX) 'Listing Rule'[4] 14 states that "a director

3 For more information about the Australian Securities and Investment Commission (ASIC), visit www.asic.gov.au.
4 For more information about ASX Listing Rules, visit www.asxgroup.com.au.

of a listed entity must not hold office (without re-election) past the third annual general meeting following the director's appointment or three years, whichever is longer" and that an election of directors must be held each year.

Many unlisted companies have also chosen to adopt this rule, as well as other Listing Rules.

Types of directors

In Australia, there are broadly two types of directors – those who work in a hands-on or executive role and who may or may not sit on a board, such as a managing director, and those who are only involved on a part-time basis at board level, such as a non-executive director. A chairman is generally a non-executive director but can be an executive director. *('Chairman' is used throughout this book as a descriptive term and is not intended to be gender-specific.)*

Non-executive directors (sometimes also referred to as NEDs) are appointed by shareholders to bring an independent and objective perspective to the board's decision-making.

The terms 'non-executive director' and 'independent director' are sometimes used interchangeably. However, not all 'non-executive' directors may be considered to be independent. The ASX *Corporate Governance Principles and Recommendations*[5] (ASX Principles) are quite specific about the meaning of independence: they define an independent director as one who "is not a member of management and who is free of any business or other relationship that could materially interfere with – or could reasonably be perceived to interfere with – the independent exercise of their judgment." If a board considers a director who does have such a relationship to be independent it should disclose this and explain why in their annual corporate governance statement.

Executive directors are employees of the company. Their main role is to carry out the day-to-day management delegated by the board. Although the terms 'managing director' and 'chief executive officer' (CEO) are often used interchangeably there is a significant difference. A managing director is a member of both the board

5 For more information about ASX *Corporate Governance Principles and Recommendations*, visit www.asx.com.au/governance/corporate-governance.htm. The current version is *Corporate Governance Principles and Recommendations with 2010 Amendments*.

and the executive team whereas, while a CEO reports to the board and usually attends all board meetings, he or she is not a director of the company and so does not vote on board issues.

The chairman[6] leads the board and plays an important role in establishing conduct at meetings. He or she is also responsible for setting the board's agenda, both annually and for individual meetings. Generally, chairmen are independent non-executive directors.

Nominee directors are those appointed to the board to represent the interests of certain stakeholders such as founding or majority shareholders, creditors, employees or government agencies. This introduces the possibility of conflict of interest (see page 8).

Governing directors are sometimes appointed by small, family companies and usually have complete control over the management of the company.

Alternate directors are appointed to take the place of directors who are unable to attend one or more board meetings. They have the same duties as any other director, are allowed to vote and are not bound by the interests of the person who appointed them. The right to appoint an alternate director is often included in a company's constitution and the appointment must generally be approved by the board.

De facto and shadow directors have not been officially appointed but are considered by law to be directors because they give instructions which are usually followed. The fact that they have not been appointed will not be accepted as a defence where there is evidence of wrongdoing.

What constitutes the company?

A company is a legal entity governed by the Act which is separate from its own directors and shareholders. All companies are regulated by ASIC. The financial services sector covering banks, credit unions, building societies, general insurance and reinsurance companies, life insurance, friendly societies, and most members of the superannuation industry, are also regulated by the Australian Prudential Regulation Authority (APRA). Guidelines are issued by organisations such as the Australian Council of Super Investors, the Australian Shareholders' Association,

6 For more information about the role of the chairman, see *Chairman of the Board*, 2012.

the Australian Institute of Company Directors and the Investment and Financial Services Association.

Each company may have its own set of rules set out in its constitution. Alternatively, companies can use provisions of the Act known as 'replaceable rules'[7] or a combination of both.

Most Australian companies fall into two categories:

1. those limited by shares, which include most business and trading enterprises
2. those limited by guarantee, which are generally purpose-based not-for-profit entities, such as sporting clubs and charitable organisations.

A company limited by shares limits the liability of shareholders to the value of their shares. It can be either private or public.

A private or proprietary company cannot offer its shares to the public. It must have 'Proprietary Limited' or 'Pty Ltd' after its name and can have no more than 50 non-employee shareholders. Proprietary companies are defined by ASIC as large or small depending on their financial size; small companies generally have reduced financial reporting requirements.

A public company, also known as a publicly-held company, may offer its shares to the public. It must have the 'Limited' or 'Ltd' after its name.

A company limited by guarantee limits the liability of its members to the amount they guarantee to contribute if the company is wound up. It does not pay dividends or distributions to its members.

It is no longer possible to register a company as limited by both shares and guarantee in Australia, however those that registered before this prohibition have been allowed to continue as such.

Outside of these two categories are **unlimited liability** companies, which place no limit on members' liability, and **no liability companies**.

Group companies

Shareholders appoint the directors to run their company; the directors owe their duty to them and future shareholders. Except in special circumstances, duty is

7 For more information about replaceable rules, visit www.asic.gov.au.

owed to shareholders as a whole, rather than to an individual or a particular group of shareholders.

In normal commercial practice, a group of companies is considered to be a single commercial entity. However, a director's duty is to a specific company, not the group as a whole except where the company's constitution specifically provides otherwise.

The duties and responsibilities of a director

There are three areas governing directors' duties and responsibilities,[8] which are as follows:

1. General law, also referred to as common law, as set out by judges in decided cases.
2. Statute law under the Act.
3. The company's constitution.

A director who acts in breach of one of these duties may have to pay compensation, face criminal prosecution and/or be disqualified from acting as a director by a regulator, such as ASIC.

Both the director and the company will also suffer the consequences of reputational damage, which can be wide-ranging and destructive.

In recent years a number of high-profile legal cases have drawn attention to directors' duties and responsibilities. These include the High Court decisions in the *James Hardie* and *Fortescue Metals Group* cases and other court decisions in the *Centro*, *Bell Group* and *OneTel* cases.

In essence, the High Court decisions in the *James Hardie* and *Fortescue Metals Group* cases underline that, in preparing announcements for release on Australian Stock Exchange and to the media, listed companies and their directors must pay close and careful attention to the content of the statements being made and the likely reaction of investors and the wider business and commercial community to those releases. The James Hardie case highlighted the importance of minutes in board operations. See the section, Minutes, on page 97.

8 For a more detailed discussion about director duties and responsibilities, as well as related legal cases, see *Duties and Responsibilities of Directors and Officers* 20th Edition by Professor Robert Baxt AO FAICD*Life*, 2012.

The *Centro* decision is a case about financial reporting which highlights that directors have a primary responsibility for the financial statements of the company that cannot be delegated. It also comments that the financial literacy expected of directors extends to a basic knowledge of accounting concepts and conventional accounting practices, and identifies limits on the extent to which directors can rely on management and auditors in approving the financial statements.

The *Bell Group* and *OneTel* decisions underscore directors' responsibilities and liabilities in insolvent company situations, and highlight the penalties to which directors can be exposed.

A director's fiduciary duties

A director enters into a fiduciary relationship with the company. It is the director's responsibility to act honestly and in good faith, and to put the interests of the company ahead of their own. As a director, you have a fundamental responsibility to act in accordance with your legal obligations and to exercise due care and diligence in overseeing that your organisation does the same.

Fiduciary duties encompass both common law and statutory obligations.

To whom do directors owe a fiduciary duty?

A director must act in the interests of the company and the company must always come first.

There are a number of situations where the interests of third parties need to be taken into account; these include creditors, where the solvency of the company is in doubt, taxation authorities, environmental matters and employees' superannuation.

As well, growing numbers of stakeholders, including such as state and federal regulators, take a close interest in how companies conduct their affairs.

The duty to act in good faith and in the best interests of the company

Directors must act for a proper purpose, in good faith and in the best interests of the company at all times. This may include taking positive steps to protect the company's interest – for instance, by using your power to prevent a transaction from proceeding.

If a director's motivation is called into question, the courts will consider what a reasonable director acting in the company's best interests would have done in similar circumstances. The courts have acknowledged that, sometimes, acting in the long-term interests of the company can result in a short-term loss.

Directors who breach their duties may be fined. However, they may also face disqualification and even criminal charges if they have behaved recklessly and/or with intentional dishonesty.

The duty to avoid conflicts of duty and interest

Directors must avoid any situation where they put their own or someone else's interests before those of the company. If this is not possible, they must immediately disclose the potential conflict, however minor, to the rest of the board or to their fellow directors if there is no board structure.

There are limited exceptions to this duty but it is important to err on the side of caution; even the suspicion of a conflict of interest can damage the reputation of both a director and the organisation.

Situations which can lead to a conflict of interest include:

- entering into a contract with a company where you are a director
- making a personal profit as a result of your position as a director without the fully-informed approval of the company
- misusing confidential company information
- serving on the board of two companies that are together engaged in takeover negotiations.

Unless the rest of the board has resolved otherwise, once a director has declared a potential conflict he or she must not vote on related matters and must leave the boardroom while these matters are being discussed. It is advisable to record these actions in the minutes.

While this ruling only applies strictly to public entities, other companies are increasingly adopting this as best practice.

In some instances, these actions may not resolve the issue. For example, if a conflict is so profound or widespread that a director is forced to spend more time absent from a board meeting than present, he or she may have no alternative but to resign.

Naturally, the requirement to give notice about conflict of interest does not apply to a proprietary company with only one director.

Nominee directors

Nominee directors owe a fiduciary duty to the company for which they are a director. They are also expected to report on the performance of that company to the organisation they represent. Clearly, this could give rise to a conflict of interest and raise the question of whether any information could or should be withheld from the nominee director.

A conflict is most likely to arise where the nominee director is involved in both sides of merger or acquisition activity – for instance, where he or she represents a major shareholder who may make a bid for ownership of the company. In this situation, the nominee director could be in danger of breaching his or her statutory and fiduciary duties while the rest of the board might be held personally liable if the conflict has an impact on the outcome of a proposed action.

Many companies seek to mitigate risk by setting out clear rules regarding the disclosure of information before a nominee director is appointed.

The duty not to misuse the position of director

This duty precludes a director from making use of the position for personal gain, for the benefit of anyone else or to cause detriment to the company.

It may be helpful to consider whether you only have access to property and information because you are a director. If so, it belongs to the company and is not yours to use elsewhere. Where there is any doubt, you should disclose any potential breach to the board, or fellow directors where there is no board, and get their formal approval before proceeding.

Examples of misuse

Competing with the company

A director must not attempt to appropriate the company's customers or, for a reasonable time after leaving the company, make use of property, such as customer lists. 'Reasonable time' is considered by regulators, or the courts, in the light of the specific circumstances and can be specified in a director's agreement with the company or organisation.

Appropriating a business opportunity

If, in your role as a director, you identify a business opportunity, you must bring this to the attention of the company rather than taking advantage of it yourself. This is the case even if you know that the company will not be able to make use of it.

Similarly, if you hear of a contract that the company might win you must not divert that contract for personal gain. Shareholders can take legal action to force a director to pay back any profits received as a result of such a breach.

Being involved in phoenix activities

Phoenix activity can involve companies who accumulate debts with the directors having an intention of liquidating the company in order to avoid repayment. They may also owe money to employees, including superannuation. Typically, the assets are then transferred into a new company (or other entity) so that the directors can continue the business using a new company structure.

Other examples of misusing the position of director

Here are other examples of the misuse of the position of director:

- diverting company funds for personal use
- causing a company to enter into an agreement which confers unreasonable personal benefits
- transferring shares at artificially inflated prices to change the balance of inter-company loans.

The duty to act with care and diligence

Directors are required by statutory codes to exercise reasonable care and diligence when managing the company's affairs. Common law adds the duty to act with skill.

You must make a positive effort to discuss, consider and use your discretion when you are acting on company matters. Even if a matter is outside your areas of expertise you must engage with it by making appropriate inquiries and staying informed. You must also scrutinise the activities of your organisation with appropriate care.

How well you discharge this duty is measured against the care and diligence that would be expected of a reasonable person in your position in a comparable organisation. Your level of expertise is also taken into consideration. All directors are presumed to be financially competent and to have a thorough understanding of the business or organisation and how it operates.

The following are examples of how directors have breached this duty:

- causing the company to enter into a transaction which had no prospect of producing any benefit for the company
- failing to hold meetings of directors
- approving financial statements with significant mistakes
- approving incorrect statements to the market
- ignoring creditors' interests when the company was in financial difficulty
- breaching continuous disclosure obligations
- convening a shareholder meeting with a notice which contained misleading and incorrect statements
- failing to ensure that the company followed authorised practices in approving loans
- failing to ensure that the company had a proper system of controls and audit
- failing to prevent money from being embezzled or mishandled
- signing a completed insurance policy without reading it
- failing to ensure that the company and auditors were properly informed
- misleading the board or inadequately disclosing material information.

The Business Judgment Rule

Risk is fundamental to business, however, there is a line between taking responsible risks with the aim of increasing the company's value and behaving without due care and diligence.

Fear of crossing this line and the subsequent consequences could cause directors to be over-cautious in their decision-making and inhibit taking sensible entrepreneurial opportunities; this was not the intention of the duty to act with care and diligence. The Business Judgment Rule (BJR) was introduced in an attempt to provide a safety net.

The Business Judgment Rule allows a court to find that directors did exercise appropriate care and diligence where the decision on behalf of the company was not motivated by personal interest, they were well informed, and acted in good faith and for a proper interest. However, the BJR applies only to the duty of care and diligence which limits its potential availability.

In the Corporations Act, the Business Judgment Rule is defined as:

A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1)[9], and their equivalent duties at common law and in equity, in respect of the judgment if they:

- make the judgment in good faith for a proper purpose; and
- do not have a material personal interest in the subject matter of the judgment; and
- inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
- rationally believe that the judgment is in the best interests of the corporation.

The duty to prevent insolvent trading

A company is insolvent if it is unable to pay all of its debts when they fall due. Directors must prevent the company from trading if it is insolvent or from incurring a debt that will cause it to become insolvent. This includes the payment of dividends; a company can only pay a dividend if the payment does not materially prejudice the company's ability to pay its creditors. It must not pay a dividend if the company would become insolvent as a result.

Before incurring any new debt you must ask yourself whether you have any grounds to suspect that the company is insolvent or that the debt will result in insolvency, or whether a reasonable person in a similar position would have grounds for suspicion. If you should ever suspect that that the company is in financial difficulty you must immediately seek professional accounting and legal advice.

While it is quite natural for directors to want to do their best to trade out of financial difficulties, many companies fail to recover from financial distress because they wait too long to seek professional help. You must also bear in mind that the consequences of allowing a company to trade while insolvent are severe and can include civil penalties, compensation proceedings and criminal charges.

9 Subsection (1) and all of the Business Judgment Rule within the Corporations Act can be viewed by visiting www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s180.html.

Civil penalties include fines of up to $200,000. A liquidator or creditors can sue directors for their own assets, not just the assets of the company, and this could lead to personal bankruptcy. If directors are found to have acted dishonestly, they could also be subject to criminal charges resulting in a fine of up to $220,000, imprisonment for up to five years, or both. If they are found guilty of the criminal offence of insolvent trading they will automatically be disqualified from sitting on a board.

The duty aims to protect unsecured creditors. Where a company is insolvent, or there is a real risk of insolvency, its duty is first to creditors, including employees with outstanding entitlements. There is a school of thought that making directors and senior executives personally liable for corporate fault is encouraging them to be unduly risk averse. For example, where a company is experiencing liquidity problems, directors may choose to call in an administrator in order to protect themselves when the interests of shareholders would be better served if the company continued to trade.

Insolvency – the warning signs

ASIC recommends that directors remain alert to the following warning signs:[10]

- The company has a history of continuing trading losses
- The company is experiencing cash flow difficulties
- The company is experiencing difficulties collecting money owed to it or selling its stock
- Creditors are not being paid on agreed trading terms and/or are either placing the company on cash-on-delivery terms or requiring special payments on existing debts before they will supply further goods and services
- The company is not paying its Commonwealth and State taxes when due – for example, pay-as-you-go instalments are outstanding, goods and services tax is payable or superannuation guarantee contributions are payable
- Cheques are being returned dishonoured
- Legal action is being threatened or has commenced against the company,

10 ASIC *Regulatory Guide 217, Duty to prevent insolvent trading: guide for directors*, Table 2.

or judgments are entered against the company, in relation to outstanding debts

- The company has reached the limits of its funding facilities and is unable to obtain appropriate further finance to fund operations–for example, through negotiating a new limit with its current financier or refinancing or raising money from another party
- The company is unable to produce accurate financial information on a timely basis that shows the company's trading performance and financial position or that can be used to prepare reliable financial forecasts
- Company directors have resigned, citing concerns about the financial position of the company or its ability to produce accurate financial information on the company's affairs
- The company auditor has qualified their audit opinion on the grounds there is uncertainty that the company can continue as a going concern
- The company has defaulted, or is likely to default, on its agreements with its financier
- Employees, or the company's bookkeeper, accountant or financial controller, have raised concerns about the company's ability to meet, and continue to meet, its financial obligations
- It is not certain that there are assets that can be sold in a relatively short period of time to provide funds to help meet debts owed, without affecting the company's ongoing ability to continue to trade profitably.

Defences

The Act does provide some statutory defences, including:

- proof that a director took all reasonable steps to prevent the company from incurring the debt
- proof that that the director was not involved in the management of the company at that time because of illness or another good reason
- that the director had reasonable grounds to believe, and did believe, that a competent and reliable person was providing adequate information about whether the company was solvent

- on the basis of this information, the director believed that the company was solvent and would remain solvent even if it incurred any extra debt under consideration.

However, it may be difficult for directors to rely on these if they have not taken steps to keep themselves informed about the company's financial position.

Directors have a duty to take reasonable steps to ensure that the company is keeping an accurate and thorough record of its financial position, performance and all transactions. Where records are not available to prove otherwise, the presumption under law is that a company was insolvent.

Directors must also maintain an accurate and up-to-date overview of the company's finances at all times; an annual review of the accounts before sign-off is not sufficient.

If the company cannot be saved

If there is no doubt as to saving the company by restructuring or refinancing, an insolvency practitioner can explain the available options and help the directors to make informed decisions about the company's future.

The Voluntary Administration regime

The Voluntary Administration regime was established as an alternative to liquidation for companies facing cash flow and other financial difficulties. The process is designed to create some breathing space by providing statutory protection from creditors while the company attempts to solve the problems causing the financial difficulty. If the company cannot recover, the Voluntary Administration regime allows for early intervention and, as far as possible, prevents the erosion of assets in order to maximise returns to creditors.

The administrator's duty is to creditors. Directors should obtain independent advice regarding their personal position.

Liquidation

If directors wish to initiate the liquidation process they must meet and vote on winding up the company and the appointment of a liquidator. A liquidator is an independent person qualified to take control of the company and wind up its affairs in an orderly and fair way for the benefit of its creditors.

Receivership

A company most commonly goes into receivership when a receiver is appointed by a secured creditor, therefore this is not usually an option for directors.

The duty of continuous disclosure

The duty of continuous disclosure that applies to listed companies is based on the principle that all investors should have equal and timely access to information about a company. It is also an important tool for minimising insider trading and other market distortions.

The ASX requires the immediate disclosure of any information which a reasonable person would expect to have a material effect on market price or value. The Act provides statutory backing for this rule.

It can be difficult to find the right balance between the need to disclose material information in a timely way against the risk of premature or incomplete disclosure of confidential information. ASIC has acknowledged that directors need a reasonable time to formulate an announcement to the market which is sensible and not misleading.

The ASX has released a draft revised *Guidance Note 8 on Continuous Disclosure*[11] for public consultation, which points out that in similar situations case law has established that the word 'immediately' should not be read as meaning 'instantaneously', but rather as meaning 'promptly and without delay'.

Policies to ensure compliance

The ASX recommends that companies create written policies to help them to comply with disclosure requirements. These should take the following into account:[12]

- the type of information that needs to be disclosed

11 To view the draft *Guidance Note 8 on Continuous Disclosure*, visit www.asxgroup.com.au/media/Guidance_Note_8.pdf.

12 ASX Corporate Governance Council *Corporate Governance Principles and Recommendations.*

- internal notification and decision-making concerning the disclosure obligation
- the roles and responsibilities of directors, officers and employees of the company in the disclosure context – in particular, who has primary responsibility for ensuring that the company complies with its disclosure obligations and who is primarily responsible for deciding what information will be disclosed
- promoting understanding of compliance
- monitoring compliance
- measures for seeking to avoid the emergence of a false market in the company's securities
- safeguarding confidentiality of corporate information to avoid premature disclosure
- media contact and comment
- external communications such as analyst briefings and responses to shareholder questions.

Duty to disclose directors' interests

Directors are obliged to promptly disclose any change in their interests in company securities; the Corporations Act specifies 14 days and the ASX five business trading days. They must also disclose the reasons for major trades.

Misleading or deceptive conduct

The Corporations Act imposes obligations on directors not to engage in misleading or deceptive conduct. In relation to continuous disclosure, these obligations are designed to protect the public from statements by directors which are likely to mislead or deceive, or to misrepresent a situation. In certain cases – for instance, where information was deliberately withheld – silence may also constitute misleading or deceptive conduct.

As the *James Hardie* case made clear (see page 6), directors must also apply due diligence to the content of their releases. For example, in deciding whether a statement might be misleading or deceptive, they should consider the audience and whether any opinions quoted are genuinely and reasonably held.

Directors' liability

Contraventions of the Act in relation to continuous disclosure may give rise to criminal liability. The courts also have the power to grant injunctions and a wide range of other orders including compensation. Directors could be personally liable and fined a maximum of $200,000 unless they can prove that they have taken all reasonable steps to ensure that the company complied with its continuous disclosure obligations and believed that it was doing so.

Where breaches are relatively minor, ASIC has the power to issue infringement notices as a fast and effective alternative to lengthy court proceedings. Paying the fine – $33,000, $66,000 or $100,000 depending on the circumstances – is not considered to be an admission of guilt or liability and, in general, ASIC will take no further action on this matter once the fine has been settled. Even directors who consider their company innocent of the alleged breach may opt to comply in order to avoid the considerable costs involved in defending any other action. Some directors also consider that prompt compliance will help to maintain their reputation in the face of the allegations.

The *James Hardie* case demonstrates the penalties directors can suffer where announcements to the market are found to be misleading. A growing trend towards multi-million dollar class actions based on allegations of breaches to the requirement for continuous disclosure are posing a further threat to some companies and their directors.

Exceptions

The obligation to disclose price-sensitive information will always apply unless all three of the following conditions are satisfied.

1. A reasonable person would not expect the information to be disclosed.
2. The ASX considers the information to be confidential.
3. One or more of the following applies:
   - disclosing the information would break the law
   - the information concerns an incomplete proposal or negotiation
   - the information comprises matters of supposition or is insufficiently definite to warrant disclosure

- the information is generated for internal management only
- the information is a trade secret.

The duty not to make improper use of information

Directors and former directors are prohibited from disclosing confidential information or making improper use of company information, confidential or otherwise – 'improper use' includes gaining an advantage for themselves or someone else, or causing detriment to the corporation.

While civil penalties generally apply, if a breach involves recklessness and/or dishonesty it may be a criminal offence.

Insider trading

Insider trading is the trading of shares or other financial products while in possession of information which is not generally available, and which would be likely to have an effect on their value. It is prohibited by the Act and the penalties are very severe. An individual can be sentenced to up to 10 years in prison and/or fined up to $450,000. The maximum penalty for a company is $4.95 million, three times the profit gained or loss avoided, or 10 per cent of the body corporate's annual turnover in the relevant period, whichever is greater.

There can be a perception of insider trading if a company's directors buy or sell shares at certain times – for example, just before the company makes a major announcement. To avoid this, and also to help prevent insider trading, the ASX requires that listed companies adopt and disclose a policy on trading in company securities by directors, executives and other employees. This policy must include:

- the company's closed periods – that is, fixed periods when directors and other key managers are prohibited from trading the company's shares
- restrictions on trading that apply to the company's directors and other key managers
- any trading which is not subject to the company's trading policy
- any exceptional circumstances in which the company's directors and other key managers may be permitted to trade during a prohibited period with prior written clearance
- the procedures for obtaining prior written clearance for trading.

Forgiveness, mitigation and insurance

The Business Judgment Rule was introduced to provide directors with a safety net in relation to their duty to act with due care and diligence (see page 12).

Elsewhere, directors can take some comfort from their entitlement to rely on others, such as management and auditors, in gathering information and making judgments. However, as the *Centro* and *James Hardie* cases have shown, this is of limited value where special duties are imposed on directors – for instance, approving the accounts or statements to market.

There are limited opportunities for the courts to minimise a directors' liability in civil cases where, allowing that risk is inherent to commercial decision-making, he or she is considered to have acted honestly. Contractual and shareholder indemnities and forgiveness can also mitigate or eliminate the obligations of directors and officers in certain circumstances but, again, these circumstances are limited.

Directors and Officers Liability Insurance

Directors and Officers Liability (D&O) Insurance is designed to protect the personal assets of directors and officers by providing indemnity for loss arising from a claim or prosecution. Most companies arrange D&O insurance on behalf of their directors and, in some cases they are obliged by deed to do so.

Directors should ensure that the cover includes indemnity for financial penalties, such as those relating to breaches of continuous disclosure under the Act, as well as civil liability for damages.

A D&O policy will not cover fraudulent, criminal or intentional acts of non-compliance, or cases where directors obtained illegal remuneration, or acted for personal profit.

Directors who are also professionals should also have relevant professional indemnity insurance.

The appropriate level of cover will vary from company to company. Factors to consider include:

- industry benchmarks for companies with a similar risk profile
- whether the company is involved in high-risk activities, such as mergers and acquisitions and capital raisings

- current trends in regulation and litigation, such as the recent increase in shareholder class actions
- the financial performance of the company over time
- the high cost of defending claims – for example, if the policy limit were $10 million and defence costs were $3 million, there would be only $7 million left to pay a claim
- the aggregate policy limit – for example, if the policy limit to pay all claims were $20 million and there were three separate claims of $10 million each including defence costs, there would be no cover for the last claim.

Directors are advised to discuss their insurance needs with an insurance broker, who will also be able to provide quotes.

> "It's important that you have Director's insurance. Check if the company you are joining is covering that for you. Obviously, you need to know the current and historical financial position of the company. But also find out about the skills of the other directors and ask questions about the culture of the board and how decisions are made."
> Marina Go MAICD

A director's rights and powers

The Act grants considerable powers to directors – broadly, they are responsible for the management of the company's business and may exercise all the powers of the company for that purpose.

Subject to the constitution, directors may confer or delegate powers on a managing director and also revoke or vary these powers. They may also delegate to another director, an employee of the company or anyone they consider appropriate – an auditor or accountant, for example. However, as the *Centro* case made clear, delegation does not release a director from his or her duties or responsibilities; advice cannot be taken on blind faith.

To enable directors to perform their duties and exercise their powers effectively during their tenure as a director, directors have certain rights and entitlements from the company they direct and in defending themselves in legal proceedings after ceasing to be a director.

A key right for directors is to have adequate information to allow them to properly meet their obligations to the company. Protocols for obtaining information should be included as part of a corporate governance charter and in a director's terms of engagement. This document would also cover a director's entitlement to:

- remuneration
- to remain in office until validly removed
- to indemnity and insurance
- access to assistance and advice
- participation in board decisions.

Three main director rights

The three main rights of directors[13] are as follows:

1. The right to receive all internal information about the company's affairs

The *Corporations Act* 2001 outlines the right of access for a currently serving director to 'financial records' (which are defined in a relatively limited way) at all reasonable times. A director may apply for a court order to allow another person to inspect and make copies of the records on their behalf. The court must be satisfied that the applicant is acting in good faith and that the inspection is to be made for a proper purpose. At common law a director is entitled as of right to inspect, and to take copies of, the books and accounts of the company. The director may exercise that right personally or employ a proper agent to make the examination for him or her.

2. The right to inspect documents

The Act gives currently serving directors the right to inspect books, other than financial records, at all reasonable times for the purposes of a legal proceeding to which they are party or wish to bring against others, or believes may be brought against them.

13 For a more detailed discussion about director rights and powers, see *Duties and Responsibilities of Directors and Officers* 20th Edition by Professor Robert Baxt AO FAICD*Life*, 2012.

Furthermore, the Act grants former directors the right to inspect books including financial records for up to seven years after ceasing to be a director. Again this only applies for the purpose of a legal proceeding. A company cannot refuse access. This period of access may be extended by the company's deeds of access.

Information can only be used by the director for the purposes of the company, e.g. if an ex-director and the company are in litigation with each other it may be difficult for the ex-director to establish that access to documents are for the purposes of the company.

Directors will want to ensure that the company keeps a complete set of board materials in chronological order from the date they join the company until seven years after they leave and confirm that copies will be available should they be needed.

3. The right to obtain insurance against liability for breaches of duty in certain circumstances

This is a complex area. Directors can obtain insurance against liability in certain circumstances but they cannot get insurance for certain breaches of the *Corporations Act* 2001. It is important to have appropriate Directors and Officers Insurance, not the least because an indemnity will be of little assistance if the company has insufficient funds to meet a claim by a director for indemnity.

What makes a good director?

A director must first have the highest ethical standards, personal integrity and a sense of duty and commitment to serving the interests of the organisation. The most effective directors also share a number of other characteristics.

Relevant skills and experience

Directors do not need specific industry experience – many acquire that experience through their work with the board. However, they do need to know how the business operates and understand basic business information well enough to be able to propose workable solutions to strategic issues. Some charitable institutions and foundations look for directors who have a particular understanding or commitment to their particular cause.

"Being good at whatever you did before doesn't mean you will automatically be a good director. You have to be prepared to have an inquiring mind and work at it." Elizabeth Carr FAICD

"Take your executive career as far as it can go before you transition to a career as a non executive director. You need C suite experience." Janice van Reyk FAICD

"I was already on a board when I decided to do some formal training. I wanted to be sure I was doing the job to the best of my ability and, after the course, I found I had a much clearer idea of my personal obligations and responsibilities and also how we as a board might deal with challenges and think more strategically." Raj Venga FAICD

Financial literacy

The findings of the *Centro* case caused many directors to question their financial skills. While directors do not need the equivalent of an accounting qualification, they do need to maintain a genuine understanding of a company's financial position. All directors should be able to read and understand financial statements and to engage in meaningful discussions with the company's auditors and accountants. The courts have made it clear that directors and officers must also satisfy themselves that they have exercised reasonable care and diligence in preparing profit forecasts, especially when that forecast is to be released to shareholders.

"Financial literacy is an integral factor of both our professional and personal lives. An organisation speaks to us about their operations and performance through the numbers it presents, such as management reports, annual reports and investor presentations. So it is fundamental that we understand the language. The duty of care and diligence we need to discharge in this area has only been heightened by the Centro case. Prospective directors who do not have financial literacy as a core competency should undertake an educational program in this area." Michelene Collopy GAICD

"It really is important to be able to read a balance sheet and profit and loss statement so if you are [on the board to add] a non-financial skill, it's worth doing a course to get yourself up to speed in this area." Marina Go MAICD

Competence in a specialised area

A director's specialist skills in an area such as accounting, finance, marketing, law, technology or international business should complement those of other directors and be relevant to the company's needs. These needs might change – for example, a specialist in mergers and acquisitions might be invaluable while the company is engaged in this kind of activity, but need to make way for someone with different skills once the process is complete.

Sound, independent judgment and a broad perspective

Key skills for directors are the ability to assimilate the information provided, ask pertinent questions and determine whether further information is required, evaluate proposals and make sound decisions. A director must be able to evaluate the company's affairs impartially.

The director needs to be able to stand back from the day to day of the business of the company when making decisions. Generally speaking, directors should be independent of management. While the ASX and APRA set out circumstances when directors will be considered to be 'independent' it is important that all directors have the ability to look critically at the matters on which they are required to decide.

> "I think the most important prerequisite is a deep understanding of the roles and responsibilities of a director. Courses like those run by the Australian Institute of Company Directors provide an excellent overview but you can't just walk away thinking 'right, I've covered that'. You need to take what they tell you about your obligations very seriously and always keep them in mind." Richard Willson GAICD

The courage to ask critical and searching questions

Directors must be prepared to challenge both management and their fellow board members. This can be difficult, particularly when they disagree with the prevailing opinion, or the opinion held by particularly strong or dominating members of the board.

Good directors will listen to other opinions with an open mind and be assertive but not aggressive in putting forward their own point of view. They will also be able to differentiate between challenging an idea and attacking an individual.

> "A new or aspiring director's great asset is a fresh pair of eyes – and there's no such thing as a dumb question." Dr Stephen Judd GAICD
>
> "The time available in a board meeting is very limited. That shouldn't stop you from raising issues or speaking out but, if your point isn't relevant to that particular meeting, you may want to consider having the discussion outside of the meeting."
> Richard Willson GAICD

Respect for fellow directors

A decision by directors is taken collectively, whether determined consensually or by majority. It binds all directors.

A strong and stable professional relationship with other directors is built on mutual respect. A directorship is a significant commitment; legally and ethically, directors must be sure that they have time to meet the demands of the role. They must be well acquainted with board processes and procedures and have a sound understanding of the accepted principles of corporate governance. They must take responsibilities seriously, such as reading board papers before each meeting. And they should be prepared to contribute an opinion but also to work as part of a team and abide by the collective decision of the board.

Becoming a non-executive director

The path to the boardroom can be long and slow. Turnover is far from rapid with most non-executive directors signing on for three terms of three years. It also takes time to build the necessary skills, experience and contacts. (For information about your professional development options, see Chapter 4.)

It is important to be realistic about your expectations and to employ a number of different strategies in your search for a role as non-executive director. For example, the Australian Institute of Company Directors provides Directorship Opportunities – an online listing service for its members – and most would-be non-executive directors will also register with an executive placement agency. When you approach an agency you should be clear about the type of role you are seeking, the industries and types of company you are interested in and how you can add value to a board. Your resume should be succinct and focus on skills and expertise that would be relevant to a board even if you have no actual boardroom experience.

While a move towards greater diversity is motivating more boards to use professional search firms, networks still play a very important role. You should be prepared to accept every reasonable networking opportunity such as attending conferences, offering to speak at relevant events and joining committees. A mentor can also help by introducing you to his or her own networks (read more about mentors in Chapter 4).

Many non-executive directors start their career with a small private company or not-for-profit organisation in order to gain experience and, again, to build networks.

Studying for specific qualifications such as the Australian Institute of Company Director's Company Directors Course[14] award demonstrates that you take the role seriously and also have a deep understanding of what it entails.

> "Most board positions come through referral, so you need to let people know that you are searching and the types of roles that interest you. It is also very important that you acknowledge the fact that anyone referring you to a board position is putting their own personal reputation on the line. You should show respect by conducting yourself professionally at all times during the process whether or not you eventually take on the role – and don't forget to say thank you!" Chris Stewart GAICD
>
> "Getting a board position is a job in itself. It requires effort and focus."
> Elizabeth Carr FAICD
>
> "Be good at your day job! Essentially, boards are seeking experienced and qualified professionals to assist them with their duties as directors and one of the best ways of getting noticed it to be good at your job." Michael Dilettoso GAICD

14 For more information about the Australian Institute of Company Directors courses, visit www.companydirectors.com.au/courses.

"An experienced director can apply his or her skills to any industry but, when you're starting out, your strong point is your industry knowledge. I think that the most effective to network is to focus on an industry or sector that you know well."
Richard Willson GAICD

"It's popular opinion that you should start out on an NFP board but I think the easier thing to do is to start with a small, privately-owned company that sees the need for one or more independent directors." Dr Stephen Judd GAICD

Conducting your due diligence

There is a temptation to say 'yes' to the first board position that comes along, particularly if you have been waiting a long time for the opportunity. However, as a director can be personally liable for the organisation's breaches of the law, joining the wrong board could be very expensive and cause irreparable reputational damage. Thorough due diligence is essential in order to establish the financial health of the organisation, its operational performance and its cultural values.

"Don't rush to take the first position you're offered even though you may be very keen to get experience. Do lots of due diligence and don't say yes until you're confident you know as much as possible about the company, the people and the way the board functions. A good board will appreciate the fact that you're taking the position seriously."
Richard Willson GAICD

"Due diligence prior to accepting a board position is critical. Find out all you can about the organisation, meet with the auditor, read past board papers and meet key management. A full induction program is essential." Michelene Collopy GAICD

"Before you accept a position, you need to talk with as many people as possible to understand the company. Are there any skeletons, internal politics or issues that may bite you later? In addition to the annual reports and financials, ask for the last few sets of minutes as these could be very enlightening." Michael Dilettoso GAICD

Are you right for the board?

You should first satisfy yourself that there are no obvious reasons why you would not be the right person for the position. Read the selection criteria thoroughly and ensure that you meet all of the requirements then check that there are no impediments such as a conflict of interest. On a practical level, you should check that you will be free to attend the scheduled meetings.

As you find out more about the board and the organisation it represents, you will also need to ask whether you believe you could make a positive contribution on behalf of the company's shareholders. You should consider whether you are likely to enjoy the role. A directorship is very demanding and you can expect to spend a considerable amount of time with the members of the new board. A difficult or unpleasant situation could adversely affect both your personal life and the quality of the work that you do.

> "A colleague of mine said that when you are considering a board role you will be told the time commitment required – but, in real life, you need to double it."
> Chris Stewart GAICD

Is the board right for you?

Thorough due diligence is complex and time consuming; you could reasonably ask all of the following questions.

The organisation itself

- What is the structure and type of the organisation?
- What is included in the constitution?
- What is the nature and extent of business activities?
- What are the strategic plans?
- Where is the organisation positioned in the marketplace? Is it gaining or losing market share? Why?
- What are its strengths and weaknesses, opportunities and threats?
- What is the explanation for any unusual movements in share prices?
- Who are the management team and the main shareholders?

Remuneration

- What is the proposed remuneration and how does it compare with similar organisations in the same industry?
- How is it is to be structured? Are there very different structures for executive directors and non-executive directors?
- Did shareholder support the remuneration report at the last annual general meeting?

Corporate governance

- Does policy encourage best practice?
- What is the work of the board and what does the board delegate to management?
- Who are the current directors and is there a suitable balance between executive and non-executive directors? What are their skills? Is there appropriate diversity?
- How frequently is the board appraised, what methods are used and are the appraisals internal or external?
- How frequently does the board meet? What information is provided and how much preparation is required?
- What is the board's relationship with the CEO? How is his or her performance reviewed, and how frequently?
- What is the induction process for new directors?
- What is a director's tenure?
- Are there effective succession plans in place for directors and the CEO?
- How does the organisation communicate with shareholders?

Finance and risk

- What is the company's current financial position and how has it performed financially over the past few years? What are the projected earnings?
- Who is responsible for managing and auditing the finances? What accounting practices do they follow?
- What are the formal and voluntary processes of disclosure?
- Have there been any criminal or regulatory investigations into the organisation?
- What are main risks faced by the organisation and what is its appetite for risk?

Liabilities

- Has the company met all of its all taxation obligations including income, payroll, land and superannuation guarantee?
- Is Directors and Officers Insurance (D&O) provided? What indemnity agreements are in place?
- Are there, or have there been, any proceedings against a director?
- What are your contractual obligations?

> "Take on a board position because you are interested in the outcomes and not because you see it as a stepping stone to another board or a way of meeting the right people. True enthusiasm will shine through – and be rewarded." Elizabeth Carr FAICD
>
> "Choose businesses in which you have an intrinsic interest and where your skills and experience are a good fit so you can make a strong contribution."
> Janice van Reyk FAICD

Gathering the information

You might ask to see the company accounts and the minutes of recent meetings as well as the last few annual reports, all media releases and analysts or rating agency reports. You will most likely be asked to sign a confidentiality agreement.

It is a good idea to speak to the chairman, the CEO and, if possible, some of the other directors, though not at the same time and, ideally, over coffee or a meal. They are more likely to speak openly about any problems in private and in a relaxed environment. Attending all or part of a board meeting will help you to get a feel for the personality and dynamics of the board.

You can also gain a great deal of information about the culture of an organisation by talking to key suppliers.

The internet has made many aspects of due diligence much easier. You can easily access information provided by the financial markets and the various regulators, particularly ASIC, as well as anything that has been reported by the media. You can also see whether anyone on the board has been associated with questionable business activities.

When the information is not available

Sometimes it is impossible to apply all of the recommended processes – for example, due diligence can be more difficult in the case of not-for-profit organisations (NFPs) and small and medium enterprises (SMEs) as less public disclosure and reporting is required of unlisted companies.

There are still many representative boards in the NFP sector, while an SME could be relatively new and in the process of moving towards an independent board.

A novice director might have no choice but to join companies that are starting up or have governance practices which differ from those in a large, well-established commercial organisation. Where documentation is limited, the internet can be particularly helpful as a source of information. You should also talk to as many people as possible who work in, or does business with, the organisation.

> "Obviously you need to know the current and historical financial position of the company. But also find out about the skills of the other directors and ask questions about the culture of the board and how decisions are made. New directors always understate the liability, especially with not-for-profits. How often the board meets and when are really important details in determining your availability. It's also worth asking expectation around representation of the organisation and what the rules and limitations are." Marina Go MAICD

Joining an IPO board

Small companies that list on the financial markets through initial public offers (IPOs) and form a new board provide opportunities for would-be directors. However, a newly-listed venture may present an even greater governance challenge than an established company.

You should take great care to ensure that you understand the company and its prospectus. Ideally, you should be involved in the IPO process, which typically takes three to six months. Extra time will also be needed to develop the board's policies, procedures and committees from scratch and to recruit other directors.

Founding shareholders may also keep a large stake in the company after listing. This could cause further problems if they continue to treat the venture like a private enterprise and have little concern for boardroom independence.

The induction process

The induction process is usually the responsibility of the chairman and the company secretary or whoever plays an equivalent role. A prospective director should be satisfied that there is an appropriate process in place.

The first step is generally a letter of appointment accompanied by an induction package of information and documentation. The new director should be introduced to his or her fellow directors and key executives and have an opportunity to become familiar with company's business, context and strategic plans. In larger, more complex organisations this process might extend over several months.

> "For me, the heart of the induction process is getting to know the other board members as people, what they like and don't like, how they work with others and how committed they are. I like to ask what surprised them when they first joined the board and what they have been most proud of since. The more factual questions of due diligence are, of course, extremely important but, given you have joint liabilities, it is important to have a sense of how the rest of the board might react in a crisis." Elizabeth Carr FAICD
>
> "Good induction is so important – it helps to build engagement and helps you to contribute constructively much faster. Many of my colleagues have commented on how little induction new board members receive so good directors may need to drive the process themselves." Chris Stewart GAICD
>
> "When the chief executive is talking about Mary and Fred, it's good to have an idea of who Mary and Fred are – better still if you've actually met them." Dr Stephen GAICD

The letter of appointment

A new director must provide a formal, signed consent to the organisation. The organisation is not required by law to confirm the appointment in writing but a letter is usually sent as a matter of courtesy and as a way of setting out the details of the role. It is generally signed by the chairman of the board.

The contents of the letter of appointment must not conflict with the *Corporations Act 2001*, the company's constitution or financial market listing rules. Legal advice should be sought if there is any doubt.

The level of detail will depend on the size, type and complexity of the organisation. The ASX *Corporate Governance Principles and Recommendations* (the ASX Principles) suggest that large public companies cover the following areas:[15]

- term of appointment
- time commitment envisaged
- powers and duties of directors
- any special duties or arrangements attaching to the position
- circumstances in which an office of director becomes vacant
- expectations regarding involvement with committee work
- remuneration, including superannuation and expenses
- requirement to disclose directors' interests and any matters which affect the directors' independence
- fellow directors
- trading policy regarding dealing in securities, including any share qualifications, and related financial instruments by directors, including notification requirements
- induction training and continuing education arrangements
- board policy on access to independent professional advice
- indemnity and insurance arrangements
- confidentiality and rights of access to corporate information
- a copy of the constitution
- organisational chart of management structure.

Letter of appointment – example

An example of a letter of appointment is set out in Appendix 1.

The induction program

A new director should receive the documentation and information he or she needs to become as effective as possible as quickly as possible. However, too much information at one time could defeat the purpose so the package may be broken down into sections and presented over a period of time with a program of induction meetings with senior managers.

15 *Corporate Governance Principles and Recommendations with 2010 Amendments*, 2nd Edition Box 1.1.

The initial information package should contain everything the director needs for the first board meeting, including the following:

- A brief outline of the role of the director' role and responsibilities; legal and best practice obligations; the organisation's policy on share trading; matters reserved for the board; any other relevant policies; and any restrictions on outside interests such as other board positions.
- The ethical and behavioural standards expected of directors.
- The latest annual reports; the strategic plan; market analysis and budget; key performance indicators; insurance policies including D&O insurance; details of any litigation or potential litigation by or against the company; and a summary of recent events such as mergers, restructuring or the introduction of new products or services.
- A copy of the constitution; minutes of recent board meetings; the board calendar; board procedures; the usual meeting place; biographical and contact details of the other directors, company secretary and the CEO; details of board subcommittees; and information about professional advisers.

The information which might be supplied to a new director in the months following the initial meeting includes:

- details of the main products or services
- risk management procedures
- details of major shareholders and the largest customers and suppliers
- company policies in areas such as occupational health and safety, discrimination, privacy and the environment.

"Induction is more than just having folders of documents to read. Good induction involves briefings from the executive team, visits to operations and informally getting to know your fellow directors. You have a responsibility to get up to speed quickly to be effective. You need to dedicate the time to do your induction well." Janice van Reyk FAICD

"In the first few meetings, listen and take it all in. Two very good pieces of advice I was given in the early stages were 'ask, don't tell' and 'two ears, one mouth ... use them in that ratio'." Chris Stewart GAICD

"A full induction program is essential." Michelene Collopy GAICD

Non-executive directors' remuneration

The majority of directors are not motivated by financial gain; despite the responsibilities and demands of the role a number earn very little or nothing at all. However, some are paid substantial sums and since the Global Financial Crisis there has been a worldwide trend towards greater regulation and shareholder control of directors' remuneration.

The Act states that, subject to the constitution, "the directors of a company are to be paid the remuneration that the company determines by resolution". The Act also states that a company may pay any travelling and other expenses that are properly incurred in connection with attending meetings and other company business.

Shareholders determine the total pool of fees to be paid to directors and must also approve any increases. The board then decides how the pool should be shared out – in general, all directors receive the same basic amount, with an extra fee if they sit on a committee or chair the board.

Non-executive directors are typically paid a fixed sum in cash, with an opportunity – or, in some companies, a requirement – to use a portion of their fee to buy shares in the company. Incentive-based pay for non-executive directors is uncommon and not considered good practice. The ASX Listing Rules specifically exclude both executive and non-executive directors of listed companies from being paid by way of commission on, or as a percentage of, operating revenue.

The Australian Institute of Company Directors provides the following ten general guidelines for non-executive remuneration:

1. Boards should have formal and transparent processes in place for determining remuneration.
2. Remuneration should reflect the duties, responsibilities and risks of the role in a reasonable manner.
3. No director should be involved in deciding his or her own remuneration; the board should seek professional advice.
4. Remuneration should be predominantly in the form of fixed fees.
5. Options should not be granted to non-executive directors unless there are special circumstances – for instance, they are on the board of a start-up company.

6. Non-executive directors should not participate in bonus schemes designed for executives
7. There should be no retirement benefits other than superannuation.
8. Boards should ensure their remuneration caps are regularly reviewed and are sufficient for the reasonably foreseeable future.
9. It is reasonable for directors to receive extra remuneration where they are required to devote substantial extra time and effort in response to an extraordinary situation.
10. The company constitutions should include clear policy on directors' fees and exertion allowances.

While the level of remuneration for non-executive directors varies greatly, Company Directors suggests taking the following into account:

- the company's existing remuneration policies
- the time needed for the task
- the risks inherent in the directorship
- the qualifications and experience of the individual concerned
- industry comparisons
- the size and complexity of the company's operations – for example, the nature and variety of its business, geographic locations, national and international diversity and technology used by directors
- the number and extent of board and committee meetings.

Single director/single shareholder proprietary companies

The company must determine any remuneration paid to the sole director and shareholder of a proprietary company by resolution. The company may also pay travelling and other expenses properly incurred by the director in connection with the company's business.