Australian Institute of Company Directors

BOARD

Board committees

The boards of larger organisations often delegate work to committees that members of the board serve on, to enable a more effective consideration of complex or specialised issues and to use directors' time more efficiently. Committees make recommendations for action to the board, thereby ensuring that the board retains collective responsibility for corporate decision making.

Involvement in committees allows directors to deepen their knowledge of the organisation, become more actively engaged and fully utilise their experience. Additionally, the existence of committees allows for more managerial talent within the company to learn about strategic initiatives and the decision making process. Committees signal the importance of key issues by the board.

Examples of committees include audit, risk, remuneration and investment committees. The nature and type of committees will vary from industry to industry and according to the size of the organisation.

Smaller companies may not benefit from a formal committee structure because their boards are often quite small and operations less complex. Nonetheless these companies will have board processes in place to cover all issues that might otherwise be considered by relevant committees.

What is required by law and the regulators?

Corporations Act 2001

Section 198D of the *Corporations Act 2001* (the Act) allows boards to delegate some of their powers to a committee of directors unless the company's constitution disallows it. The delegation must be recorded in the minute book. The section permits other forms of delegation of board powers, for example to an employee, on the same basis.

Section 190 provides that, when directors delegate a power under s 198D of the Act, they remain responsible for the exercise of the power by the delegate as if it had been exercised by the directors themselves. There is a limited exception where the director who delegates will not be held responsible if the director believed:

- On reasonable grounds at all times that the delegate would exercise the power in conformity with the duties imposed by the Act and the company's constitution (s 190(2)(a)); and
- On reasonable grounds; and in good faith; and, after making proper inquiry if the circumstances indicated the need for inquiry; that the delegate was reliable and competent in relation to the power delegated (s 190(2)(b)).

Section 189 gives authority for the rest of the board to reasonably rely on the information or advice given by a committee so long as it is independently assessed by the board and is relied upon in good faith. Note however, that a delegation of authority is not one of exoneration of the board's overall duties and responsibilities.

ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*

The ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*[1] (ASX Principles) recommends that the boards of listed entities establish three committees:

- Audit committee (Recommendation 4.1)
- Remuneration committee (Recommendation 8.1)
- Nomination committee (Recommendation 2.1)

In addition, the ASX Principles recommend that that boards should have a committee or committees to oversee risk. In some cases, this function is combined with the audit committee. In other cases, it is a standalone committee of the board. Each of the above committees is discussed in more detail below.

Importantly, the ASX Principles are not mandatory because they recognise that different entities may legitimately adopt different governance practices for many reasons including; organisational culture; history; size; and, complexity. The ASX Principles do however apply to all entities admitted to the ASX official list as an ASX listing, and they work on an *if not, why not* basis, meaning that they are generally not mandatory but listed companies who do not comply with them must explain in their annual report why they have not followed the recommendations. The *if not, why not*, approach serves to ensure that the market receives an appropriate level of information about the governance principles an entity has adopted.

Australian Prudential and Regulation Authority

Australian Prudential and Regulation Authority (APRA) is the prudential regulator of Australian financial services companies, whether listed or unlisted. It imposes prudential standards for authorised deposit taking institutions (for example, banks, building societies and credit unions) and general and life insurers as well as regulated superannuation funds. Key requirements of the standards include the establishment of an audit committee and a remuneration committee.

More detail about the prudential standards may be found on APRA's website[2].

What are the most common committees?

Each board will have deliberations as to the number and kind of committees that will serve the board function most efficiently. This process ought to be subject to feedback and review to ensure that the board's governance function is optimised to ensure that the relevant committees add value to the company subject to the mandatory requirements discussed below. Committees may be of an ongoing nature like the audit committee, usually referred to as 'standing committees', or may be formed for a specific short-term project.

Audit, remuneration and nomination committees are the most common committees. Other committees may be necessary for organisations in specific industries: for example, a resources company may have an environmental committee, an airline may have a safety committee, a charity may have a fundraising committee.

Audit committees

A listed company's audit committee is subject to mandatory requirements. Firstly, ASX Listing Rule 12.7 requires that a company included in the S&P All Ordinaries Index at the beginning of its financial year must have an audit committee during that year.

Secondly, if the company was included in the S&P ASX 300 Index at the beginning of its financial year, it must also comply with the structure and disclosure requirements of the ASX Principles Recommendation 4.1 for the whole of that financial year, unless it had been included in that Index for the first time less than three months before the beginning of that financial year.

A company that is included in the S&P ASX 300 Index for the first time less than three months before the first day of its financial year but did not comply with the ASX Principles Recommendation 4.1 at that date must take steps so that it complies with those recommendations within three months of the beginning of the financial year.

1. ASX Corporate Governance Council, 2019, *Corporate Governance Principles and Recommendations*, 4th edition, February, **https://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-fourth-edn.pdf**, (accessed 8 May 2019).
2. APRA, *Industry standards and guidance*, [website], **https://www.apra.gov.au/industry-standards-and-guidance**, (accessed 18 February 2019).

Some of the recommendations under the ASX Principles Recommendation 4.1 to be complied with include:

- **Structure** – at least three members, only non-executive directors, majority of independent directors, independent chair who is not chair of the board;
- **Charter** – the committee should disclose the charter of the committee;
- **Member experience** – the committee should disclose the relevant qualifications and experience of its members;
- **Meetings** – the committee should disclose the number of times it met throughout the year.

There are similar requirements for institutions that are regulated by APRA (see for example Prudential Standard CPS 510 Governance). APRA makes clear that for those institutions regulated by them that the board audit committee is to assist the board by "providing an objective non-executive review of the effectiveness of the institution's financial reporting and risk management framework".[3]

More generally, the audit committee[4] plays a key role in assisting the board to fulfil its corporate governance and oversight responsibilities in areas including:

- corporate reporting, including external financial reporting, the directors' report and annual report;
- external audit;
- internal audit;
- risk management and internal control;
- compliance;
- ethics and organisational culture; and
- fraud and corruption.

The main responsibilities of an appropriately established and effective audit committee may include assisting the board to discharge its responsibility to exercise due care, diligence and skill in relation to the following areas:

- promoting and monitoring an ethical culture throughout the entity;
- ascertaining that a code of conduct is appropriately designed and implemented and compliance with the code is monitored;
- reviewing the effectiveness of risk oversight and management;
- assessing the entity's fraud risk and action to mitigate that fraud risk;
- assessing the effectiveness of the internal control system in relation to accounting and financial records and reporting;
- assessing the adequacy of financial management practices;
- overseeing the systems in place to protect the entity's assets;
- reviewing the adequacy of internal and external reporting (financial and non-financial) to users of financial reports;
- overseeing compliance with applicable laws, regulations, standards and best practice guidelines, including reviewing correspondence with regulators;
- providing a formal forum for communication between the board and senior financial management;
- obtaining an independent, effective and efficient external audit, including assessing audit quality and independence matters;
- facilitating effective communication between the board and the internal and external auditors, and providing timely and appropriate responses to matters arising from audits; and
- considering significant matters that were raised during both the internal audit and external audit.

The audit committee's responsibilities are typically documented in its charter. Ideally, the audit committee's annual work plan is derived from its charter to ascertain whether the committee has fulfilled its responsibilities on a yearly basis.

The audit committee can assist directors to fulfil their responsibilities and facilitate decision making by:

- facilitating open communication between board members and senior management, risk and compliance managers, internal and external auditors; and
- focusing on matters within the audit committee's charter, thereby allowing the full board to spend more time on other matters.

To be effective, the audit committee must be independent from management and free from any undue influence. Members of the audit committee should not have any executive powers, management functions or delegated financial responsibility of the entity.

3. APRA, 2019, *Prudential Standard CPS 510 Governance*, July, p 17, **https://www.apra.gov.au/sites/default/files/prudential_standard_cps_510_governance.pdf**, (accessed 9 August 2019).
4. Refer to Auditing and Assurance Standards Board, Australian Institute of Company Directors and The Institute of Internal Auditors–Australia, *Audit Committees: A guide to good practice*, 3rd edition, 2017, The Auditing and Assurance Standards Board, the Australian Institute of Company Directors, the Institute of Internal Auditors–Australia

Remuneration committee

ASX Listing Rule 12.8 provides that a company included in the S&P ASX 300 Index at the beginning of its financial year must have a remuneration committee, comprised solely of non-executive directors, for the entire duration of that financial year.

For APRA regulated institutions, Prudential Standard CPS 510 requires that there be a remuneration committee unless exempted by APRA. This committee must have at least three members who are all non-executive directors of the institution. A majority of the members of the committee must be independent directors. The chair must be an independent director.

For other companies, the ASX Principles Recommendation 8.1 applies on the usual *if not, why not* basis. It suggests that remuneration committees have a minimum of three directors, the majority of whom are independent, and be chaired by an independent director.

The main functions of the remuneration committee include:

- disclosing its charter, its members and the member attendance at all meetings held for each financial year;
- reviewing policies and practices and making recommendations to the board in relation to remuneration, recruitment, retention and termination of directors, the CEO and senior executives;
- ensuring the company makes the necessary disclosure to the market regarding remuneration (in accordance with the requirements of s 300A of the Act);
- responsibility for the adoption of the remuneration report (see ss 250R and 250SA of the Act);

The remuneration committee should review the organisation's remuneration frameworks closely for alignment to the desired culture. As part of this, organisations should consider whether staff are rewarded for 'doing the right thing'. It would also involve reviewing the appropriateness of performance metrics used (including non-financial metrics), whether robust assessment occurs (that considers both what has been achieved and how it has been achieved), and whether individuals are adequately held to account through remuneration outcomes.

Nomination committee

The ASX Principles Recommendation 2.1 suggests that nomination committees have a minimum of three directors, the majority of whom are independent, and be chaired by an independent director.

The main functions of the nomination committee include:

- disclosing the charter of the nomination committee, its members and the member attendance at all meetings held during the year (at the end of the reporting season);
- assessing the organisation's needs in terms of skills, knowledge and experience for board directors, CEO and senior management;
- making recommendations to the board regarding appointments, retirements and terms of office;
- assessing and reviewing directors' inductions, performance and development; and
- ensuring proper succession planning for the board and key executives.

Where a nomination committee is not established, then the company ought to disclose that fact and make clear the alternative method it uses to address board succession issues in ensuring that the board has the appropriate balance of skills, knowledge, experience, independence and diversity to enable it to discharge its duties and responsibilities effectively.

Risk committee

Many boards, especially in larger organisations, have established a risk committee to oversee the risk management framework operating within the company. In some organisations, this function has been combined with the role and responsibilities of the audit committee to establish an audit and risk committee.

The ASX Principles Recommendation 7.1 provides that the board of a listed entity should have a committee or committees to oversee risk, each of which should have a minimum of three members, a majority of whom should be independent. Recommendation 7.2 also provides that the risk management framework should be reviewed at least annually.

The role of a risk committee is to oversee the effective operation of the risk management framework.
This includes:

- disclosing the charter of the risk committee, its members and the member attendance at all meetings held during the year (at the end of the reporting season);
- making recommendations to the board to improve the risk management framework including monitoring management's performance against the organisation's risk management framework;
- monitoring the significant risks of the organisation including the effective operation of risk mitigation strategies including the review of any material incident;
- approving the internal audit plan and reviewing reports received from the internal audit on the adequacy of the organisation's risk management processes;
- contributing to the identification and evaluation of risks facing the organisation, including regularly reviewing and identifying new and emerging sources of risk and their mitigation plan; and
- making recommendations to the board on necessary changes to the organisation's risk management framework, including attitudes towards and implementation of appropriate risk appetite.

What goes into a committee charter?

To facilitate effective operations, a committee will have a clear purpose outlined in a written charter. Charters will vary according to the type of committee. although they will usually state:

- role, purpose and responsibilities;
- scope of authority, extent of power and decision making abilities;
- membership requirements and procedure for meeting attendance by non-committee members;
- composition and structure;
- frequency of meetings;
- terms of access to internal and external resources and information;
- requirements for reporting to the board;
- special powers of the committee chair; and
- tenure.

Who can be committee members?

It is widely accepted in Australia, and also a requirement of some committees (for example, audit committees for S&P ASX 300 Index companies), that the majority of committee members will be independent non-executive directors. It is recommended that committee members be also suitably qualified in terms of abilities, knowledge and experience.

Committees must be large enough to allow for proper consideration and debate of issues but not be so large that decisions cannot be reached. In practice, most committees will have three or four members, usually on rotation (every few years). Non-executive directors who are not committee members are often allowed to attend committee meetings as observers, in which case a statement to this effect should appear in the committee's charter.

Public companies must disclose the number of meetings of each board committee held during the year and each director's attendance at those meetings in its annual report (s 300(10) of the Act).

How and what should a committee report to the board?

This question should be addressed in the committee's charter. Responsibility for taking the minutes of each committee meeting is usually assigned to the company secretary. The minutes capture the key deliberations, show options for action and make recommendations for the board to endorse or decide upon.

The minutes, or a written report of the meeting, will be included in the board papers for the next board meeting. The information contained will reflect the needs of the board and include, for example, highlighted key issues, options and recommendations for required decision making.

If a committee meeting occurs just before a board meeting, the committee chair should present a verbal summary of key points raised at the committee meeting, with the minutes to follow.

Should committees be evaluated?

The board must continually monitor each committee's activities as part of their duties of care, diligence and good faith. A committee's charter should be evaluated annually to ensure that it is appropriately focused and that the committee is fulfilling its functions. If not, amendments should be made.

Recommendation 2.5 of the ASX Principles also requires regular board performance evaluations, including a review of the performance of its committees.

Does sitting on a committee carry extra legal liability?

The question of whether committee membership increases the liability of a director has not yet been fully explored in Australian law. This is especially an issue for the audit committee. Technically, all directors share responsibility for decisions equally. As outlined above, when directors delegate a power to a committee under s 198D of the Act, they remain responsible for the exercise of the power by the committee as if they had exercised it themselves (s 190).

However, there is an exception if the director believed on reasonable grounds at all times that the delegate would exercise the power in conformity with the duties imposed by the Act and the company's constitution; and the director believed on reasonable grounds and in good faith (and after making proper inquiries if the circumstances so required) that the delegate was reliable and competent in relation to the power delegated (s 190(2)).

About us

The Australian Institute of Company Directors (AICD) is committed to strengthening society through world-class governance. We aim to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. Our membership includes directors and senior leaders from business, government and the not-for-profit (NFP) sectors.

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