BOARD

Role of the board

Reference to *board* in this document means the group of individuals (howsoever described or called) in whom the governance, control, direction and management of the organisation is vested in accordance with its constituent documents or by legislation.

It includes:

- In the case of a company – its board of directors;
- In the case of an incorporated association – its committee of management;
- In the case of a statutory authority or public sector organisation – its board of directors or duly appointed council.

The board is responsible for the overall governance, management and strategic direction of the organisation and for delivering accountable corporate performance in accordance with the organisation's goals and objectives. This responsibility is usually set out in the organisation's constitution or in the enabling legislation under which the organisation is registered or incorporated.

In performing its role, specific responsibilities commonly reserved to the board either in its constitution, its board or governance charter (or by cultural practice) include:

- Providing strategic direction to the organisation and deciding upon the organisation's strategies and objectives in conjunction with the CEO;
- Monitoring the strategic direction of the organisation and the attainment of its strategies and objectives in conjunction with the executive;
- Monitoring the operational and financial position and performance of the organisation generally;
- Driving organisational performance so as to deliver member value or benefit;
- Assuring a prudential and ethical base to the organisation's conduct and activities having regard to the relevant interests of its stakeholders;
- Assuring the principal risks faced by the organisation are identified and overseeing that appropriate control and monitoring systems are in place to manage the impact of these risks;

- Reviewing and approving the organisation's internal compliance and control systems and codes of conduct;
- Assuring that the organisation's financial and other reporting mechanisms are designed to result in adequate, accurate and timely information being provided to the board;
- Appointing and, where appropriate, removing the CEO, monitoring other key executive appointments, and planning or monitoring executive succession or management capability planning;
- Overseeing and evaluating the performance of the CEO, and through the CEO, receiving reports on the performance of other senior executives in the context of the organisation's strategies and objectives and their attainment;
- Reviewing and approving the CEO's and, in conjunction with the CEO, other senior executive remuneration;
- Approving the organisation's budgets and business plans; and monitoring major capital expenditures, acquisitions and divestitures, and capital management generally;
- Ensuring that the organisation's financial results are appropriately and accurately reported on in a timely manner in accordance with constitutional and regulatory requirements;
- Appointing and, where appropriate, removing the company secretary;
- Ensuring that the organisation's affairs are conducted with transparency and accountability;
- Overseeing the design, implementation and periodic review of appropriate and effective policies, processes and codes for the organisation, which depending on the organisation, may include with respect to ethics, values, conduct, securities trading, disclosure of securities' price sensitive information, employment, remuneration, diversity and otherwise;
- Ensuring sound board succession planning including strategies to assure the board is comprised of individuals who are able to meet the responsibilities of directors of the organisation;
- Overseeing member and stakeholder engagement, reporting and information flows.

What is the role of the board?

In the *Final Report Royal Commission in to Misconduct in the Banking, Superannuation and Financial Services Industry Volume 1*, Commissioner Hayne makes the following comment: "The task of the board is overall superintendence of the company, not its day-to-day management. But an integral part of that task is being able and willing to challenge management on key issues, and doing that whenever necessary".[1]

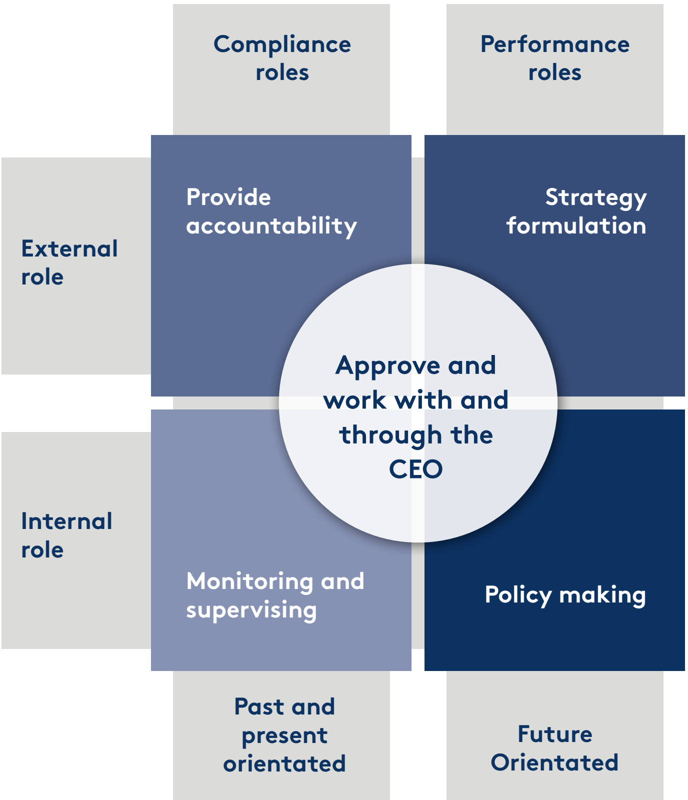
In organisational terms, the role of the board includes governing, directing and monitoring an organisation's business, affairs and operations in two broad areas:

1. **Overall organisational performance** – ensuring the organisation develops and implements strategies and supporting policies to enable it to fulfil the objectives set out in the organisation's constitution. Commonly, the board delegates the day to day operations of the organisation to the management team via the CEO but remains accountable to the members and shareholders for the organisation's performance. The board monitors and supports management in an ongoing way.
2. **Overall organisational compliance/ conformance** – ensuring the organisation develops and implements systems, processes and procedures to enable it to comply with its legal, regulatory and industry obligations (complying with the law and adhering to accounting and other industry standards) and ensure the organisation's assets and operations are not exposed to undue risks through appropriate risk management.

1. K M Hayne, 2019, *Final Report Royal Commission in to Misconduct in the Banking, Superannuation and Financial Services Industry Volume 1*, February, Commonwealth of Australia, p 400, **https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf**, (accessed 4 September 2019).

The differing emphasis of these two areas of organisational performance and conformance/compliance responsibilities can result in conflicting pressures on boards and their members. Boards must balance these roles and give appropriate attention to both.

The following model by Professor Robert Tricker provides a useful guide to the performance and compliance dilemma for boards and their directors:



The board's role in the organisation's governance

Corporate governance can be defined as the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations. There are practical benefits for an organisation in having effective corporate governance. Some studies indicate firstly, a correlation between strong organisational performance and a good or effective practice of corporate governance and secondly that corporate governance is a significant factor for investors, in particular institutional investors, to consider when making investment decisions.

Boards are responsible for the corporate governance of their organisations. There is no one size fits all when it comes to what constitutes good corporate governance for an organisation. Much depends on various aspects including the organisation's size (scale and geographic spread), people (skills and experience), business model (mature or evolving), nature of operations (relatively simple or complex), regulatory exposure and risk profile.

In Australia, corporate governance of ASX listed public companies operates on an *if not, why not* approach rather than mandatory detailed regulation as is more common in the USA. This approach means that, in general, a company does not have to comply with the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*[2] (ASX Principles) but, if it does not, then it must disclose and explain in its annual report or other public statement on its governance the reason(s) why not. This approach aims to provide guidance while allowing the flexibility in application of the principals and ensuring transparency for investors and other stakeholders about the reasons why the entity has chosen not to follow the principals.

2. 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 August 2019).

Getting the right skills on the board

Boards function best when they have a broad mix of skills, knowledge, experience and diversity. Different directors have different skills and backgrounds. The goal in selecting board members is to build a mix that can work as a well-rounded team of people each with an appropriate range of experience skills and attributes relevant to the purpose, needs and strategies of the organisation. In selecting a new board member, the board should consider the skills, knowledge, attributes and experience needed to govern the organisation both now and in the future.

It is important to select board members who have sufficiently broad experience in the issues and opportunities the organisation is facing now or is likely to face in the future. Furthermore, board renewal is also critical to board performance. A mix of longer serving directors and some with shorter tenures can assist in sustaining corporate memory in the boardroom and add fresh and new perspectives.

While specific skills required by each board differ, there are some core skills that should be represented on a board as a whole (not necessarily in one person).

These include:

- **Strategic expertise** – the ability to set and review strategy through constructive planning, questioning and suggestion;
- **Accounting/financial literacy** – the ability to read and comprehend the accounts and the financial material presented to the board, in addition to understanding financial reporting requirements – the Centro case (*ASIC v Healey* (2011)) has emphasised the need for basic financial literacy for all board members;
- **Legal skill** – the ability to understand and oversee compliance with numerous (and changing) laws;
- **Governance skill** – experience and understanding that a board's role is not to be involved in the day to day operation but, instead, to oversee and monitor operational performance;
- **Managing risk** – experience in risk management and mitigation principles;
- **Human resource skills** – experience in human resource management;
- **Marketing and communications** – experience in media and marketing (potentially including social media);
- **Industry knowledge** – experience in similar organisations or industries;
- **Information technology** – there is a growing need for directors with an understanding of information technology, communication technology (such as social media channels), data protection and cyber security;
- **Capital markets experience** – experience in capital raising and mergers and acquisitions.

Boards or their nomination committee should maintain a board skills matrix which records the available skill sets of individual directors to ensure required skills and knowledge are captured. Boards should regularly review the matrix to identify any skills gap. If certain skills or knowledge is missing or lower than the expected level of competence, boards should consider:

- appointing a new director with the desired skill and experience (which may take time);
- inviting experts or consultants with relevant knowledge to provide advice; or
- providing professional development opportunities for board members to enhance overall capability.

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If boards are to be kept to a manageable size, then at least some board members may need to individually possess a number of these attributes and skills. Additionally, if an organisation has special needs or exposure to a particular stakeholder group, it makes sense to include a director who has experience in that area. For example, an organisation that spends a great deal of time doing business with government may need someone with first-hand experience of the bureaucratic and political process. Care should be taken by boards not to appoint and invariably rely upon an individual director as a specialist advisor to the organisation.

As diversity of perspective is seen as a valuable addition to a board's deliberations, boards should have a diversity policy which has measurable objectives for achieving diversity including diversity of gender, age, ethnicity and life's experiences at board-level. The current ASX Principles suggests boards of listed entities achieve a gender diversity balance in their board composition of not less than 30 per cent of its directors from either gender.

Board decision making?

All board decisions are made collectively and, unless absent, all board members share equal responsibility for board resolutions even if they may have expressed reservations at the time. This collective responsibility, accountability and wisdom (with its implicit checks and balances) provides an important feature of good governance and decision making of Australian boards.

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What are board committees?

Boards are responsible for monitoring and overseeing many aspects of an organisation. To help cope with the scope of work and the technical complexities of some of these aspects, boards create committees of some of their members to review issues and make recommendations to the board for collective decision making. In large public companies these committees generally include the audit committee, the risk committee, the remuneration committee and the nominations committee. Some boards also have committees that focus on governance in the areas of the environment, health and safety and community and stakeholder relationships.

There are specific audit committee related requirements for companies within the S&P/ASX All Ordinaries Index and the S&P/ ASX 300 Index.Listing Rule 12.7 requires a company in the S&P All Ordinaries Index at the beginning of its financial year to have an audit committee during that year. If the company was in the S&P/ASX 300 Index at the beginning of its financial year, it must follow Recommendation 4.1 of the ASX Principles on the composition, operation and responsibility of the audit committee.

There are also specific remuneration committee related requirements for companies within the S&P/ASX 300 Index. Listing Rule 12.8 says that an entity 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. The board of a listed entity should also follow Recommendation 8.1 of the ASX Principles on the composition, operation and responsibility of the remuneration committee.

Boards have discretion to adopt or reject a board committee's recommendations or to refer the decision back to the committee for re-consideration. If the board delegates the formal exercise of any of its powers to a committee, it is important to note that the board and its directors remain responsible for the exercise of that power by that committee, subject to any *fair delegation* defences that may be available (for example, for companies registered under the *Corporations Act 2001* (Cth), refer s 190). To avoid confusion, it is recommended that each committee establish a committee charter outlining respective roles, responsibilities and authorities. It is also recommended that the annual board calendar contain dates of all board committee meetings.

The board's role in selecting a CEO

One of the most crucial roles of the board is to select the CEO for the organisation. As the leader of the management team, the value of the CEO to the organisation cannot be underestimated. The board and CEO should aim to work in close co-operation with one another.

CEO succession planning is an important aspect of the board's role. The needs of an organisation will change over time and a CEO who is an excellent appointment today and in the short term may not be the best person for the longer term. For example, an organisation undergoing a period of major change can benefit from a CEO with skills and experience in this area but may respond better to a CEO with a different skill set when the period of major change is over, and the circumstances are more settled.

Boards should regularly undertake a periodic CEO performance assessment to monitor and evaluate CEO performance against position description or any pre-agreed performance indicators. An open and constructive relationship between board chair and CEO will be useful for providing feedback to CEO on a regular and more informal basis.

The board's role in strategic planning

Developing and setting a clear strategy for the organisation and then implementing it are vital to the success of an organisation. Without clarity of strategic purpose and certainty about what the organisation does and doesn't do, the organisation may have trouble achieving its objectives.

An important part of developing and implementing strategy is to clearly delineate between the roles of the board and management. The level of board contribution to strategic thinking and planning may vary according to the organisation, its current situation, its size, its people and a number of other factors. Large businesses tend to have a strong and highly skilled executive team who can help in formulating the essence of a sound strategic direction for consideration and approval by the board. In this case, the board's role may centre more on questioning, challenging and clarifying.

In smaller organisations the board itself may play a more instrumental role supporting management in the development of strategy prior to its submissions to the board for approval.

In smaller organisations the board itself may play a more instrumental role supporting management in the development of strategy prior to its submissions to the board for approval. An organisation in crisis, during major change or expansion might also require greater board involvement than usual.

Generally, management has the responsibility of implementing the strategy so it is important that the key executive management personnel support and understand it.

To formulate strategy, offsite sessions are often recommended by business commentators and advisers to minimise distraction and to allow a different type of thinking from day to day or regular work to occur. Annual sessions are common in strategy development and review, although more frequent reporting (at least quarterly or half yearly) is common with respect to the board monitoring the organisation's progress against its strategic plan. Developing and communicating a clear strategy for the organisation can help to build stakeholder and investor confidence.

The board's role in setting ethical standards?

Compliance with the law is the minimum standard for running an organisation. There are ethical values which should govern the way in which an organisation operates. The final report of the Prudential Inquiry into the Commonwealth Bank of Australia recommended that all boards should embed *should we?* questions (rather than *can we?*) in their decision-making processes.[3] In the *Final Report Royal Commission in to Misconduct in the Banking, Superannuation and Financial Services Industry Volume 1*, Commissioner Hayne also recommended directors "to form and then to give practical effect to their understanding of what is ethical, of what is efficient, honest and fair, of what is the 'right' thing to do".[4] It is now widely accepted that inculcating those values in an organisation's culture is an essential role for the board. For example, Principle 3 of the ASX Principles advises that "a listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and responsibly".[5]

All directors would do well to heed the advice of Justice Owen, who conducted the HIH Insurance Royal Commission inquiry into the collapse of the HIH insurance group:

> *Did anyone stand back and ask themselves the simple question – is this right? …Right and wrong are moral concepts, and morality does not exist in a vacuum. I think all those who participate in the direction and management of public companies, as well as their professional advisers, need to identify and examine what they regard as the basic moral underpinning of their system of values.*[6]

The role of the board in APRA-regulated organisations?

The prudential standards of the Australian Prudential Regulation Authority (APRA) outline special requirements for directors of its regulated entities, such as banks, building societies, insurance companies and superannuation funds. There are *fit and proper* standards relating to responsible persons who are the directors and senior management. To be accepted as *fit and proper* a director must have the necessary skills, knowledge, experience, diligence and soundness of judgement to undertake the duties of the role.[7]

3. J Laker, J Broadbent and G Samuel, 2018, *Prudential Inquiry into the Commonwealth Bank of Australia*, Australian Prudential Regulation Authority, April, Recommendation 21, p 103, **https://www.apra.gov.au/sites/default/files/CBA-Prudential-Inquiry_Final-Report_30042018.pdf**, (accessed 3 June 2019).
4. K M Hayne, 2019, *Final Report Royal Commission in to Misconduct in the Banking, Superannuation and Financial Services Industry Volume 1*, February, Commonwealth of Australia, p 410, **https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf**, (accessed 4 June 2019).
5. ASX Corporate Governance Council, 2019, *Corporate Governance Principles and Recommendations*, 4th Edition, February, p 16, **https://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-fourth-edn.pdf**, (accessed 8 August 2019).
6. J Owen, 2003, *The Failure of HIH Insurance: Volume 1, A Corporate Collapse and its Lessons*, pp lxii-lxiii.
7. Refer to Australian Prudential Regulation Authority, 2018, *Prudential standard CPS 520 Fit and proper*, **https://www.apra.gov.au/sites/default/files/prudential_standard_cps_520_fit_and_proper.pdf** (accessed 4 June 2019).

People who have been unwilling to comply with legal obligations, have breached fiduciary duties, been negligent or deceitful, have been disciplined, disqualified or subject to an enforcement action by a professional or regulatory body regarding honesty and integrity, have been *substantially involved* in a business failure or held in bad repute in a business community are deemed to not be *fit and proper*. APRA expects an annual review of a person's fitness and propriety.[7]

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Lastly, in the *Final Report Royal Commission in to Misconduct in the Banking, Superannuation and Financial Services Industry Volume 1*, Commissioner Hayne recommends six norms of conduct be embedded in operations[8]:

- obey the law;
- do not mislead or deceive;
- act fairly;
- provide services that are fit for purpose;
- deliver services with reasonable care and skill; and
- when acting for another, act in the best interest of that other.

The context of these recommendations concern conduct by entities in the financial industry, they appear equally applicable more broadly.

8. K M Hayne, 2019, *Final Report Royal Commission in to Misconduct in the Banking, Superannuation and Financial Services Industry Volume 1*, February, Commonwealth of Australia, pp 8-9, **https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf**, (accessed 4 June 2019).

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For more information **t:** 1300 739 119 **w:** companydirectors.com.au