



**Australian Government**  
**Corporations and Markets**  
**Advisory Committee**

# **GUIDANCE FOR DIRECTORS**

## **Report**

**APRIL**  
**2010**

Corporations and Markets **Advisory**  
**Committee**

Guidance for directors

Report

**April 2010**

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This report is available at:

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A copy of this report can also be requested by:

email: [camac@camac.gov.au](mailto:camac@camac.gov.au)

fax: (02) 9911 2955

phone: (02) 9911 2950

or by writing to:

Corporations and Markets Advisory Committee

GPO Box 3967

SYDNEY NSW 2001



Australian Government

Corporations and Markets Advisory Committee

Level 16, 60 Margaret Street, Sydney  
Telephone: (02) 9911 2950  
Email: [camac@camac.gov.au](mailto:camac@camac.gov.au)

GPO Box 3967 Sydney NSW 2001  
Facsimile: (02) 9911 2955  
Website: [www.camac.gov.au](http://www.camac.gov.au)

30 April 2010

The Hon Chris Bowen MP  
Minister for Financial Services, Superannuation and Corporate Law  
Parliament House  
CANBERRA ACT 2600

Dear Minister

I am pleased to present a report by the Advisory Committee on guidance for directors.

The report responds to your letter of 12 August 2009 on this subject.

Yours sincerely

A handwritten signature in black ink that reads 'Richard St. John'. The signature is fluid and cursive, with a large initial 'R' and 'S'.

Richard St. John  
Convenor



## Contents

<b>1</b>	<b>Introduction .....</b>	<b>1</b>
1.1	Reference to the Committee .....	1
1.2	Ambit of review .....	3
1.3	Advisory Committee.....	4
<b>2</b>	<b>The challenge for directors .....</b>	<b>7</b>
2.1	Position of directors .....	7
2.2	Legal environment .....	11
2.3	Accountability of directors .....	13
2.4	Scope for guidance .....	15
<b>3</b>	<b>Guidance available in Australia .....</b>	<b>17</b>
3.1	Overview .....	17
3.2	Legislation .....	20
3.3	Judicial decisions .....	20
3.4	Regulators .....	21
3.5	ASX Corporate Governance Council .....	27
3.6	Inquiries and other reports .....	31
3.7	Private initiatives and services.....	36
<b>4</b>	<b>Guidance available overseas .....</b>	<b>47</b>
4.1	Introduction .....	47
4.2	United Kingdom .....	47
4.3	North America .....	61
4.4	International standards.....	64
<b>5</b>	<b>Advisory Committee response .....</b>	<b>73</b>
5.1	Matters for consideration.....	73
5.2	Preliminary comments .....	73
5.3	International guidance .....	76
5.4	Adequacy of guidance in Australia.....	78

<b>Appendix 1</b>	<b>Letter from the Minister .....</b>	<b>85</b>
<b>Appendix 2</b>	<b>AICD activities .....</b>	<b>89</b>
<b>Appendix 3</b>	<b>CSA activities .....</b>	<b>97</b>

# 1 Introduction

*This chapter outlines the terms of reference and the review process and provides background.*

## 1.1 Reference to the Committee

### 1.1.1 Minister's letter

By letter of 12 August 2009 (a copy of which is Appendix 1), the Minister for Financial Services, Superannuation and Corporate Law, the Hon. Chris Bowen MP, asked CAMAC to:

- examine the guidance or codes of conduct that are available overseas for corporate directors;
- examine whether there is sufficient guidance provided to executive directors and non-executive directors in Australia to ensure that they have a clear understanding of their roles and responsibilities; and
- advise whether the performance of directors would be enhanced by the introduction of guidance for directors, for example through a code of conduct or best practice guidance, by a relevant regulator; and if so what form that guidance should take.

The Minister asked the Committee to report by 30 April 2010.

In his letter, the Minister noted the importance of maintaining a system of corporate governance that is in line with international best practice. He observed that both executive and non-executive directors play an integral role in ensuring corporate governance best practice. In this context, the Minister was particularly interested in whether any additional support could be provided 'to increase the engagement of NEDs [non-executive directors] with their position on the board and bring an independent and broad view to board decision making'.

The Minister drew attention to developments in the United Kingdom, particularly the Higgs Review and the subsequent

*Combined Code on Corporate Governance*, which ‘now provides a basic level of guidance to NEDs about their responsibilities on the board’.

While the Minister recognised that industry representative organizations in Australia give some guidance to directors on their responsibilities, he considered it ‘unclear whether this level of guidance is leaving current, and potential, NEDs confident in the expectations and responsibilities that are placed on a NED role’.

### 1.1.2 Background

Company directors, both individually and collectively as a board, have an integral role in the corporate governance system. The way in which they carry out their role and perform their duties sets the direction and tone of a company’s governance and performance.

The Minister noted that ‘while Australia has a world-class corporate governance framework, the importance of continuing to assess it against international best practice has been highlighted by the recent global economic crisis’. The Johnson report *Australia as a Financial Centre* (November 2009) has also pointed to the importance of boards implementing and continually maintaining world’s best practice standards in corporate governance to underpin Australia’s position in the international financial services and corporate sector.

There have been reviews outside Australia of the corporate governance implications for directors and boards of the global financial crisis, including the failure of some prominent banking institutions in other countries. These include the Organisation for Economic Co-operation and Development (OECD) report *Corporate Governance and the Financial Crisis: Key Findings and Main Messages* (June 2009) and the Basel Committee on Banking Supervision report *Principles for enhancing corporate governance* (March 2010). The Walker report *A review of corporate governance in UK banks and other financial industry entities: Final recommendations* (November 2009) examined governance practices in UK banking and other financial institutions.

In addition to reports responding to the global financial crisis, there have been more general initiatives concerning the role of directors, such as the UK Financial Reporting Council review of the *Combined*

*Code on Corporate Governance*, which includes a review of director and board performance.

While Australia has been spared some of the high profile corporate failures that occurred in other countries, lessons about approaches to risk management and other matters emerging from the recent period of destabilisation in financial markets are likely to have relevance for companies in Australia. Also, cases in which the conduct of directors and the performance of their functions and responsibilities are called into question continue to arise throughout the business cycle, including *Hall v Poolman* [2007] NSWSC 1330, *ASIC v Macdonald (No 11)* [2009] NSWSC 287 and *ASIC v Rich* [2009] NSWSC 1229 in recent times.

## 1.2 Ambit of review

The Minister has sought the advice of the Committee on whether there is a need to provide directors individually, and collectively as a board, with further guidance on how to fulfil their roles, and, if so, how this might be achieved.

Guidance in this context could cover compliance matters, including the duties and responsibilities of directors, structural and procedural issues concerning the composition and functioning of a board and board committees, and broader behavioural matters, such as the understanding by directors of their stewardship role and of how to work together effectively with board colleagues and management to achieve good outcomes for their company.

The questions raised are considered in the context of the existing legal framework. The Committee is not being asked to review the duties or liabilities of directors or to consider law reform proposals to change or clarify these matters.

Directors may hold office in a range of incorporated entities, including:

- companies listed on the Australian Securities Exchange (ASX)
- unlisted public companies
- companies limited by guarantee
- closely held or family-owned companies

- not-for-profit entities
- government business enterprises
- other public sector bodies.

The report is generally directed to the circumstances of directors of a governance board, being a board that has full responsibility for the running of a company. Circumstances may differ for directors of a board that undertakes advisory or other limited functions and is not wholly responsible for running the entity.

The report has particular regard to the circumstances of directors of a publicly listed company, though the matters discussed may also have relevance to directors of other entities.

The report focuses on the role of individual corporate officers in their capacity as directors. It does not address issues that may arise for executive directors in undertaking managerial responsibilities in addition to their responsibilities as directors.

The Committee has not undertaken empirical research on the extent to which directors in Australia understand their roles and responsibilities. Also, having regard to the subject matter and timetable for the review, the Committee did not engage in a formal public consultation process. The Committee did obtain information from various bodies that provide guidance services to directors and thanks them for their assistance. Information about the position outside Australia was obtained from published material.

In Chapter 2, the Committee examines the challenges facing directors in carrying out their roles and responsibilities. Chapters 3 and 4 consider the guidance available in Australia and elsewhere, including that provided by regulators and the private sector, to assist directors in carrying out their role. In Chapter 5, the Committee sets out its conclusions on the matters in the terms of reference.

### 1.3 Advisory Committee

The Advisory Committee is constituted under the *Australian Securities and Investments Commission Act 2001*. Its functions include, on its own initiative or when requested by the Minister, to provide advice to the Minister about corporations and financial services law and practice.

The members of the Advisory Committee are selected by the Minister, following consultation with the States and Territories, in their personal capacity on the basis of their knowledge of, or experience in, business, the administration of companies, financial markets, financial products and financial services, law, economics or accounting.

The members of the Advisory Committee are:

- Richard St John (Convenor)—Special Counsel, Johnson Winter & Slattery, Melbourne
- Zelinda Bafile—Lawyer, Director and former General Counsel and Company Secretary, Home Building Society Ltd, Perth
- Ian Eddie—Professor of Accounting, School of Commerce and Management, Southern Cross University, Tweed Heads
- Belinda Gibson—Commissioner, Australian Securities and Investments Commission
- Alice McCleary—Company Director, Adelaide
- Marian Micalizzi—Chartered Accountant, Brisbane
- Geoffrey Nicoll—Co-Director, National Centre for Corporate Law and Policy Research, University of Canberra
- Ian Ramsay—Professor of Law, University of Melbourne
- Robert Seidler—Partner, Blake Dawson, Sydney
- Greg Vickery AM—Partner, Norton Rose, Brisbane.

Nerolie Withnall, Company Director, Brisbane was also a member of the Advisory Committee and the Convenor of the Legal Committee for the greater part of the review.

A Legal Committee has been constituted to provide expert legal analysis, assessment and advice to the Advisory Committee in relation to such matters as are referred to it by the Advisory Committee.

The members of the Legal Committee are selected by the Minister, following consultation with the States and Territories, in their personal capacity on the basis of their expertise in corporate law.

The members of the Legal Committee are:

- Greg Vickery (Convenor)—Partner, Norton Rose, Brisbane
- Lyn Bennett—Partner, Hunt & Hunt, Darwin
- Elizabeth Boros—Barrister-at-Law, Melbourne
- Damian Egan—Partner, Murdoch Clarke, Hobart
- Jennifer Hill—Professor of Law, University of Sydney
- James Marshall—Partner, Blake Dawson, Sydney
- David Proudman—Partner, Johnson Winter & Slattery, Adelaide
- Simon Stretton—South Australian Crown Solicitor, Adelaide
- Gabrielle Upton—Legal Counsel, Australian Institute of Company Directors, Sydney
- Rachel Webber—Special Counsel, Jackson McDonald, Perth.

The Executive comprises:

- John Kluver—Executive Director
- Vincent Jewell—Deputy Director
- Thaumani Parrino—Office Manager.

## 2 The challenge for directors

*This chapter outlines the role of directors in the governance of a company, the legal and commercial context in which they operate and some of the demands they face. It looks at areas in which directors may be able to benefit from guidance.*

### 2.1 Position of directors

#### 2.1.1 Responsibilities

The directors of a company have the primary responsibility for its governance on behalf of the shareholders by whom they are elected. Their role is to oversee the operation of the company's business on behalf of the shareholders to whom they are accountable. They have the ultimate responsibility for the company's direction and performance:

The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting.<sup>1</sup>

The position of a company director is generally one of considerable influence and ultimate power but limited day-to-day control of the affairs of the company. The realisation of that influence and power by an individual director is, however, dependent on the nature of his or her interaction with fellow directors on a company board.

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<sup>1</sup> *Report of the Committee on the Financial Aspects of Corporate Governance (1992) (the Cadbury Committee)*, para 2.5. Section 198A of the Corporations Act (a replaceable rule) provides that the business of a company is to be managed by or under the direction of the directors. The power of the directors is subject to powers reserved to the shareholders under the Corporations Act, listing rules (for listed entities) or the corporate constitution.

### 2.1.2 Board structure

Apart from some minimum requirements,<sup>2</sup> there is no one model for the way directors carry out their role as individuals or collectively as a board. They may be more or less ‘hands on’ in relation to the operation of the business and it is open to them to allocate particular responsibilities among particular board members. In practice, a unitary approach is the norm, under which directors bring together their varying skills, knowledge and experience and work together collectively as a board, in reaching decisions and in meeting their other obligations.

Some board members—in recent times usually a minority of the board<sup>3</sup>—have designated executive duties in addition to their roles as directors. The other—non-executive—directors are less likely to have an active involvement in the operation of their company, particularly if it is a large one. They normally hold office on a part-time basis. The expectation is that non-executive directors will be available for board meetings and otherwise as reasonably required.

The trend in recent years, encouraged by corporate governance guidelines, has been to have fewer executive directors. With non-executive directors, stress has been placed on appointing individuals who meet specified criteria for independence from the company and its management. There is potential for tension if the premium placed on formal independence (as distinct from independence of mind) works at the expense of industry and other knowledge and experience that will assist the board in dealing effectively with strategic issues and commercial decisions.

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<sup>2</sup> A public company must have at least three directors, of which two must ordinarily reside in Australia: Corporations Act s 201A(2). Only a natural person, who is at least 18 years old, may be appointed as a director of a company: s 201B(1).

<sup>3</sup> The larger ASX-listed companies generally have between four and nine directors on their boards, with more than two thirds of them being non-executive directors: Korn/Ferry International and Egan Associates, *Board of Directors Study Australia and New Zealand 2009* at 14-17. The ASX Corporate Governance Council *Corporate Governance Principles and Recommendations* include a recommendation that a majority of the board, including the chair, be independent directors: ASX Corporate Governance Council *Corporate Governance Principles and Recommendations* (Second edition, 2007) Recommendations 2.1, 2.2, 2.3.

### 2.1.3 Demands and expectations

In order to carry out their role, directors need to understand the fundamentals of the company's business and the market in which it operates. They need to keep informed about the company's activities and financial position. Non-executive directors, being part-time and having no managerial role, have a limited ability to oversee the day-to-day business of a company. All directors can face challenges in keeping abreast of a company's affairs, particularly where it has a large and complex business and operations in different places.

### 2.1.4 Relationship with management

As a practical matter, especially in large companies, the board's role is a supervisory one: it engages a chief executive and management team to run the company on a day-to-day basis. Directors face a challenge in keeping sufficiently abreast of what is happening in the company's business to be able to discharge their responsibilities. The directors are reliant to a considerable degree on the capacity of management to carry on the business on the board's behalf, including the implementation of board decisions, and to keep the board informed about matters material to the performance and direction of the company.

In many cases, directors have to look to the advice of management and internal or external experts and advisers in reaching decisions for which, as a board, they are responsible. They therefore have a stake in, as well as responsibility for, the quality and conduct of their executive team. The delegation and allocation by the board of responsibilities and authorities within the company, and the clarity of processes and requirements for reporting of information, are also important.

The extent to which a director can rely on the advice of management and other advisers continues to be a live issue. The reasonableness of reliance in particular circumstances may be affected by the extent to which the director was prepared to test particular advice and keep the reliability of those providing advice under review.<sup>4</sup>

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<sup>4</sup> Sections 189, 190 and 198D deal with the question of delegation and reliance on information or advice provided by others.

These considerations reinforce the importance of good judgment by the board in appointing appropriate key executives and advisers, keeping their reliability and performance under review and overseeing their remuneration and other benefits.

The Advisory Committee report *Corporate duties below board level* (April 2006) pointed out that, in most medium to large enterprises, operational decision-making devolves to managers and other individuals below board level, who conduct the business of the company subject to higher-level supervision by the board of directors. The report made various recommendations to take into account these commercial practicalities and the need for appropriate legal responsibility at executive as well as board level.

### **2.1.5 Board effectiveness**

Non-executive directors are also expected to bring an independent and inquiring mind to their role. As observed in the UK *Combined Code on Corporate Governance*:

As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy. Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible.

Boards commonly seek to support their deliberative processes by the use of committees, including board nomination committees, audit committees, remuneration committees and risk management committees. This practice has been encouraged by corporate governance guidance in recent years. Participation on committees increases the commitment required of board members, particularly non-executive directors who are often expected to play the leading role on them. Board committees are not an end in themselves. They can assist a board in its decision-making through preliminary examination of information and analysis. However, the full board normally retains ultimate collective responsibility for matters dealt with by its committees.

While individual directors carry full personal responsibility for their stewardship of the company, the reality in most cases is that they are only able to affect decisions or the course followed by the company

by their contribution to the collective deliberations of the board. Individual board members will generally be bound by, and accountable for, the decisions and performance of their board. It follows that a director's personal skills and behaviours in working together with board colleagues play an important part in that director's personal effectiveness as well as the effectiveness of the board overall. The directors have to work together and bring their collective skills and judgment to bear in providing leadership for the company and carrying out the obligations of the board.

It follows also that an individual board member has a stake in the effectiveness of his or her colleagues and of the whole board. Questions such as the adequacy of the mix of relevant skills and experience on a board to meet the challenges of the company, the ability of the chair to guide open and constructive deliberation and the ability of board members to work together and with management should be matters of concern for each director as well as the board overall.

It is increasingly recognised that part of a board's responsibility is to keep under review its own composition and effectiveness, including the performance of individual board members, in light of current and anticipated developments in the company's business and operating environment.<sup>5</sup> Directors themselves carry a responsibility to consider these matters, to ensure the best performance of the board for the benefit of shareholders. As pointed out in the HIH Royal Commission report *The failure of HIH Insurance* (2003), good corporate governance:

is about the way the directors of a company create and develop a [corporate governance] model to fit the circumstances of that company and then test it periodically for its practical effectiveness.<sup>6</sup>

## 2.2 Legal environment

Directors are subject to fiduciary and other legal duties and obligations. They must exercise their powers and discharge their duties 'in good faith in the best interests of the corporation' and 'for

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<sup>5</sup> See further the Advisory Committee report *Diversity on boards of directors* (March 2009) at Section 4.4.

<sup>6</sup> Volume 1 at 133.

a proper purpose'.<sup>7</sup> They are also required to act with the degree of care and diligence that a reasonable person would exercise in the same position.<sup>8</sup> Directors must avoid conflicts of interest, such as using their corporate position or corporate information to gain an advantage for themselves or someone else or to cause detriment to the corporation.<sup>9</sup>

Depending on their activities, companies are also subject to a range of legislative and reporting requirements, including under environmental protection, occupational health and safety, workplace relations, competition, consumer protection, human rights (such as anti-discrimination) and anti-corruption statutes. In some circumstances, directors may be deemed personally liable for breaches of the legislation by their companies and be subject to criminal or civil liability for that misconduct unless they can make out a relevant defence.

As noted in the Advisory Committee report *Personal liability for corporate fault* (September 2006), the number and complexity of statutes, and varying standards for the imposition of personal liability on directors, may detract from the ability of directors in good faith to implement effective compliance programs. There is also a danger that directors can become unduly preoccupied with matters of compliance at the expense of focus on entrepreneurial activities, and the undertaking of risks for the benefit of shareholders. As one earlier commentary pointed out:

Boards have two distinct roles, monitoring (or a concern with conformance) and performance enhancement. As a monitor, the board's task is to ensure that management runs the company in the interests of shareholders, other stakeholders and in accordance with the law. As performance enhancer, the task is to act as a constructive partner with top management and especially the chief executive in improving the viability and value of the enterprise over time. ... What we are finding is that the board's list of responsibilities is expanding, and that most of the new activities fall into the conformance rather than performance category. ... Moreover, many of these new responsibilities are sheeted home to directors personally, so

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<sup>7</sup> Corporations Act s 181.

<sup>8</sup> Corporations Act s 180.

<sup>9</sup> Corporations Act ss 182, 183.

that there is considerable individual incentive to overkill on compliance, even if the cost is less board attention on long-term performance.<sup>10</sup>

A board of directors should be more than a high level audit or compliance committee.

The Advisory Committee personal liability report analysed a range of Commonwealth, State and Territory environmental, occupational health and safety, hazardous goods and fair trading laws. While not exhaustive of all statutes applicable to directors and boards, these laws are instances of the imposition on directors and other corporate managers of personal criminal liability in consequence of breaches of the law by their companies. The Committee considered that, as a general principle, individuals should not be penalised for misconduct by a company unless it can be shown that they have personally assisted or been privy to that misconduct, that is, were accessories. There has subsequently been acceptance in principle of that approach at the inter-governmental level but implementation of any changes may take some time.<sup>11</sup>

## 2.3 Accountability of directors

### 2.3.1 Accountability to shareholders

Directors are accountable to shareholders for the performance of the company. While the success or otherwise of the company at a particular time may be attributable to market conditions or other factors, shareholders can more reasonably hold directors accountable for performance over a longer term.

As a formal matter, the constitution of a board is in the hands of the shareholders. While the usual practice is for the directors of a

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<sup>10</sup> *Strictly Boardroom: improving governance to enhance company performance* (The Business Library, 1993) at 17-18.

<sup>11</sup> In November 2009, the Ministerial Council for Corporations (MINCO), comprising Federal, State and Territory governments, agreed on the principles for reform of the directors' liability provisions in their respective legislation, based on those recommended in the CAMAC report *Personal liability for corporate fault* (September 2006). All jurisdictions agreed to audit their legislative provisions that impose personal liability on company directors for corporate fault.

company to appoint someone to fill a casual vacancy on the board,<sup>12</sup> an appointee to the board of a public company can remain as a director only with the approval of shareholders at the company's next annual general meeting.<sup>13</sup> The maximum tenure of a director of a public company is three years, unless reappointed by shareholders.<sup>14</sup> Also, the shareholders of a public company may remove a director at any time by ordinary resolution.<sup>15</sup>

As a practical matter, however, it is fair to say that boards largely determine their own continuing composition. A more formal approach to the process by which they nominate new appointees, including the use of nomination committees, has been encouraged in recent years. It is also possible that increasing shareholder activism and greater engagement by institutional investors will change this balance.<sup>16</sup>

Shareholder suits against companies and their controllers are another means by which shareholders may seek to hold a company and its controllers to account. While more common in the USA, there are signs of an increase in such claims in Australia, including instances of shareholder class actions supported by litigation funding:

In effect, the facilitation of private [shareholder] remedies has added to the enforcement armoury, encouraging

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<sup>12</sup> s 201H(1). This is a replaceable rule, which could be overridden by a contrary appointment provision.

<sup>13</sup> s 201H(3). This is also reflected in ASX Listing Rule 14.4, which provides that a director appointed to fill a casual vacancy on, or as an addition to, the board of a public listed entity must not hold office, without re-election by shareholders, past the next annual general meeting of the entity.

<sup>14</sup> ASX Listing Rule 14.4 provides that a director of a listed entity must not hold office, without re-election by shareholders, past the third annual general meeting following the director's appointment or 3 years, whichever is the longer.

<sup>15</sup> s 203D. There is conflicting case law on whether the procedure under s 203D provides the only means by which shareholders can remove directors.

<sup>16</sup> The Government has announced that it will introduce legislation to strengthen the non-binding shareholder vote on remuneration (s 250R), including the 'two strikes proposal' by which shareholders will be able in some circumstances to bring about a spill of board positions, as recommended in the Productivity Commission Inquiry Report *Executive Remuneration in Australia* (December 2009): Joint Treasury Media Release No. 033 of 16 April 2010 *Government responds to the Productivity Commission report on executive remuneration*.

self-help by affected parties to complement the enforcement role of the regulators.<sup>17</sup>

### 2.3.2 Public accountability

Directors can be called to account by regulators or others for their improper conduct or other failings, which may lead to the imposition of criminal or civil penalties or disqualification from the office of director.

The performance of directors is also open to media and other public scrutiny. When a company fails, there can be a tendency to attribute responsibility to directors for all of its shortcomings, regardless of the respective roles of directors and management and other circumstances.

## 2.4 Scope for guidance

Directors operate in an evolving commercial environment and within a demanding legal framework. They need a clear understanding of their role, its potential and its limits. They need skills and knowledge relevant to the company and its business and commitment to advancing the company's interests. They need the ability to discern the interests of a company and put them first, avoiding personal and other conflicts of interest. They also need the personal skills to work effectively on a board and to interact constructively with management and others.

While the needs of individual directors will vary, most will be able to benefit from the example and guidance of successful directors, the accumulated wisdom of others and articulated measures of best practice.

It is to be expected that some directors or boards will have more to gain from particular forms of guidance than others, and needs may change over time. The individual circumstances of directors differ considerably, ranging from seasoned long-term directors who have developed a strong understanding of their role and how to carry it out, through to persons with little relevant prior experience; persons

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<sup>17</sup> Advisory Committee report *Shareholder claims against insolvent companies: Implications of the Sons of Gwalia decision* (December 2008), Section 3.4.

who are tertiary-educated through to persons with no professional qualifications; and persons who are accustomed to working with lawyers and other professional advisers through to persons who are not. There are also differences in the circumstances that may be faced by directors of a large established listed company and the directors of a newly listed start-up business or of a smaller proprietary company.

The availability of guidance does not mean that those who could benefit from it will in fact look for assistance or make use of it. Some directors and boards will be more prepared than others to seek advice on financial, legal or governance issues. Their decisions will be influenced by various factors, including their level of relevant experience and expertise, perceived relevance of particular guidance to identified needs, changing regulatory, market or industry requirements or expectations, the cost of particular products or services and the time they have available.

The line between prescription—that is, the laying down of standards that must be followed in a regulation or law as a requirement—and the offering of guidance that is aimed at helping people in the way that they carry out their role needs to be kept in mind. While guidance can be promoted and encouraged, and leadership and example can be influential, in the end there is a limit to how far one can require directors to help themselves. This is not to devalue the worth of guidance for directors. It is simply a reminder that with some aspects of human behaviour, it is difficult to go beyond recommendation and advice to those who must take responsibility in the end for their own decisions and actions.

## 3 Guidance available in Australia

*This chapter reviews the sources of guidance available in Australia to assist directors to understand and fulfil their role.*

### 3.1 Overview

#### 3.1.1 Scope of guidance

As described below, there is a good deal of guidance available to directors in one form or other from sources both official and private.

##### ***Compliance***

Guidance commonly takes the form of advice or assistance to directors, and boards, in understanding and responding to legal duties and other regulatory requirements. It aims to help directors understand the legal obligations and constraints on themselves and their companies and how to avoid falling into breach.

##### ***Governance***

Increasing interest in the ways and means by which companies are governed in practice has led to more guidance becoming available in this area.

As pointed out by the HIH Royal Commission, corporate governance is not a term of art:

At its broadest, the governance of corporate entities comprehends the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations. It includes the practices by which that exercise and control of authority is in fact effected.

The relevant rules include applicable laws of the land as well as the internal rules of a corporation. The relationships include those between the shareholders or owners and the directors who oversee the affairs of the corporation on their behalf, between the directors and those who manage the affairs of the corporation and carry out its business, and within the ranks of management, as well as between the corporation and others to whom it must account, such as regulators. The systems and processes may be formal or

informal and may deal with such matters as delegations of authority, performance measures, assurance mechanisms, reporting requirements and accountabilities.<sup>18</sup>

Relevant guidance is directed to issues such as board structures and processes, internal controls and systems for risk management, financial reporting, monitoring of management and operational activity.

### ***Behavioural matters***

There has also been an increasing recognition of the importance of personal and behavioural aspects of the role of directors and the way in which they work together, and with management, in an effective way. The elements that make up an effective board include a mix of personal skills, talents and experience that is appropriate for the needs of the company, constructive dynamics within the board and leadership from the chair.<sup>19</sup> Directors, regardless of their individual talents, need to be able to work effectively with their colleagues to bring about decisions and outcomes in the best interests of the company. Guidance can be directed to these matters, including the development of the necessary personal and interpersonal skills, as well as processes for the review of individual and board effectiveness.

### ***Change in emphases***

Interest in and understanding of corporate governance change over time. The evolution of thinking is affected by changes in economic and market conditions, fallout from business cycles, the success or failure of particular companies and the conduct or example of individuals, as well as changing legal and regulatory requirements or the uncertainties they sometimes create. Developments in research and thinking may also be a factor. All this can lead to shifts in focus or emphasis in relation to recommended best practice standards.

The recent destabilisation in global financial markets has led to a renewed emphasis on effective risk management as a key element of governance in financial services in particular. The role of the board

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<sup>18</sup> HIH Royal Commission report *The failure of HIH Insurance* (2003) Volume 1 at 101-102.

<sup>19</sup> See further the Advisory Committee report *Diversity on boards of directors* (March 2009), Chapter 4.

in shaping and overseeing the remuneration and other benefits given to management has also come in for renewed attention in the light of concerns, including an apparent disconnection between reward and performance in some sectors. The failure of some notable overseas financial institutions has reopened questions about the balance between formal independence and relevant industry expertise on a board.

There has also been a growing emphasis on the need for directors to take collective responsibility for their own board's effectiveness in advancing the interests of the company, including through processes for review and renewal of board membership.

### 3.1.2 Sources of guidance

Guidance is available to directors in Australia from a number of sources and in a variety of ways. They include:

- *legislative direction*: in a sense, the relevant legal framework, including the Corporations Act, and other legislation, is a source of guidance to directors and others engaged in corporate activity
- *decisions by the courts*: these illuminate the application of the law in particular cases
- *regulators*: ASIC and other regulators by their activities and policies and other statements can inform understanding of aspects of regulation for which they have responsibility
- *ASX*: the ASX Corporate Governance Council has issued *Corporate Governance Principles and Recommendations* for listed entities
- *inquiries and other reports*: these focus on particular corporate governance episodes or issues
- *private sector initiatives and services*: these include guidance from companies themselves, professional and industry bodies, peer groups and mentoring programs, as well as from legal, accounting and corporate advisory firms and tertiary education institutions.

A major focus of legislative and judicial guidance, as well as much of the guidance by regulators, is on legal duties and compliance

matters. Guidance from the ASX Corporate Governance Council looks at some broader corporate governance issues, as does some of the other private sector guidance.

Legal and other advisers and consultants also draw on available guidance material in distilling and explaining for the benefit of directors the corporate governance implications of legislative, judicial or other developments.

There is a level of competition in the private sector for the attention of directors or their advisers and other intermediaries. This process helps to drive the development of new or revised guidance products or services, some of which seek to respond to perceived gaps that may arise from time to time in existing coverage, or to deal with legal or other developments affecting directors and boards. This guidance process can help resolve areas of uncertainty or identify issues that may require further regulatory clarification or attention.

### 3.2 Legislation

The Corporations Act and other legislation relevant to the operation of companies (as well as common law principles) provide a legal framework within which directors operate.

The Corporations Act is a substantial piece of legislation regulating many aspects of corporate and financial market activity, including the powers and duties of directors. The legislation has grown over the years, with considerable detail and complexity in some areas. While it contains some guidance as to its content, such as the *Small business guide*,<sup>20</sup> it remains an onerous and complex piece of legislation. Directors will often be dependent on the advice of lawyers and other professionals in relation to the relevance of particular provisions to their company and decisions they take.

### 3.3 Judicial decisions

Decisions by the courts on the meaning or application of statutory or common law principles relevant to directors and corporate activities illuminate how the law applies in particular circumstances and can assist understanding by others. Judicial decisions can identify, apply,

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<sup>20</sup> Corporations Act Part 1.5.

explain or reinforce corporate governance principles or otherwise inform directors and boards about considerations relevant to the performance of their powers, duties and responsibilities.

In *ASIC v MacDonald (No 11)* [2009] NSWSC 287, for instance, the Court provided guidance on the application of the statutory duty of care and diligence<sup>21</sup> where directors approve a materially false public statement by the company to the market. In *Hall v Poolman* [2007] NSWSC 1330 at [261]-[275], the Court provided guidance on the circumstances in which a director might have a sufficient ‘expectation’ of solvency to satisfy the defence to an action for insolvent trading.<sup>22</sup> *ASIC v Rich* [2009] NSWSC 1229 at [7178]-[7295] contains a detailed review of the statutory duty of care and diligence and the business judgment rule,<sup>23</sup> including an analysis of the case law, a summary of the relevant legal propositions, and their application to various classes of directors and executive officers.

Legislative and other legal requirements, as well as judicial decisions, spell out the legal framework for corporate activities and the conduct of directors. They are less likely to provide guidance to directors on the commercial challenges they face or on processes and behaviour conducive to effective governance.

### 3.4 Regulators

The Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA), through the exercise of their administrative powers, the publication of regulatory guides and their enforcement decisions, provide direction and guidance on a range of issues related to their regulatory responsibilities. ASIC has general responsibility for corporate regulation, while APRA deals with the prudential regulation of banks and other entities in the financial services industry. The views of regulators may be seen as carrying particular weight, especially where a regulator sets out its approach to and interpretation of particular statutory and other requirements and how they will be

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<sup>21</sup> Corporations Act s 180.

<sup>22</sup> Corporations Act s 588H(2), (3).

<sup>23</sup> Corporations Act s 180.

enforced. Likewise, guidance issued by the Takeovers Panel can be useful for directors of bidder or target entities.

Depending on the particular sector in which a company operates and the nature of its operations, directors and boards also have to deal with a range of taxation, environmental, occupational health and safety and other matters. Regulatory agencies such as the Australian Competition and Consumer Commission and various government departments and agencies provide guidance in particular areas.

### 3.4.1 ASIC

One of ASIC's functions is to facilitate and improve the performance of the financial system and the entities within that system. In the course of its activities, ASIC provides direction and guidance to directors and their advisers in various ways, particularly in regard to various compliance obligations.

ASIC makes available a *Company incorporation pack*, including Information Sheet 61 *How to register a company*, which explains the procedure for establishing a company and provides a checklist of the legal obligations of officeholders.

ASIC forwards a *New officeholder pack* to new officeholders,<sup>24</sup> advising them of various responsibilities, setting out further information, and referring them to the ASIC website ([www.asic.gov.au](http://www.asic.gov.au)), which contains guidance for directors, and others, in the form of regulatory guides, consultation papers and information sheets.

ASIC Information Sheet 79 *Your company and the law* refers to the powers, duties, roles and responsibilities of a company officeholder, including the personal obligations of the officeholder to maintain appropriate books and records, act honestly and be aware of the company's activities. It provides details of matters that must be notified to ASIC and refers officeholders to the ASIC website for further information and additional resource material. Also, the ASIC newsletter *InFocus* is issued periodically for people operating companies.

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<sup>24</sup> Every company is required to notify ASIC of the appointment of each director: Corporations Act ss 201L, 205B.

ASIC provides guidance on general areas of concern to directors and others through its regulatory guides and consultation papers. These publications seek to:

- outline when and how ASIC will exercise specific legislative powers
- explain how ASIC interprets the law
- describe the principles underlying ASIC's approach
- give practical guidance, such as describing the steps in a compliance process.

ASIC Consultation Paper 124 *Duty to prevent insolvent trading: Guide for directors*, for instance, is intended to provide guidance to directors to help them understand and comply with their duty to prevent insolvent trading. It:

- discusses the relevant legal background to the director's duty to prevent insolvent trading
- sets out four principles that ASIC considers directors should follow when endeavouring to meet their obligation to prevent insolvent trading:
  - directors must keep themselves informed about the company's financial affairs, and regularly assess the company's solvency
  - directors should investigate financial difficulties immediately they identify concerns about the company's financial viability
  - directors should seek appropriate professional advice to help address the company's financial difficulties; and
  - directors should consider and act appropriately on the advice received, in a timely manner
- identifies some of the factors ASIC will take into account in assessing whether directors have contravened the Corporations Act by allowing a company to trade while insolvent, in light of the key principles set out above.

A final Regulatory Guide on insolvent trading is expected in 2010.

Other regulatory guides aimed specifically at directors include:

- ASIC Regulatory Guide 193 *Notification of directors' interests in securities—listed companies*
- ASIC Regulatory Guide 22 *Directors' statement as to solvency*.

Other ASIC regulatory guides deal with particular corporate activities in which directors will be involved, including fundraising, market disclosures and change of control or other corporate reorganizations.<sup>25</sup>

In addition, ASIC *Information sheets* provide concise guidance on specific process or compliance issues or give an overview of detailed guidance. ASIC *Reports* describe ASIC compliance or relief activity or the results of research projects.

ASIC provides additional information on a subscription basis. The *ASIC Working Guide for Company Directors* contains material extracted from the ASIC Digest of particular relevance to company directors. Areas covered include lodging documents, prospectuses, directors' independence, takeovers, share schemes, shareholder notices and relevant ASIC media and information releases. The *ASIC Policy Alert* notifies changes to, and new releases of, regulatory guides, pro-formas, class orders and policy-related media releases and advisories. The information sent can be specifically tailored for particular audiences, including directors.

ASIC provides guidance through media releases and standardised letters to companies on announced priority areas on which it will focus, for instance financial statements in annual reports. Also, speeches by ASIC Commissioners or other representatives can identify ASIC thinking or approach on particular matters of relevance to directors and boards.

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<sup>25</sup> See, for instance, the analysis of ASIC Regulatory Guide 60 *Schemes of arrangement* in the CAMAC report *Members' schemes of arrangement* (December 2009).

### 3.4.2 APRA

The Australian Prudential Regulation Authority (APRA) is the prudential regulator of the financial services industry. It oversees banks, credit unions, building societies, general insurance and reinsurance companies, life companies, friendly societies, and most members of the superannuation industry. APRA focuses on the prudential regulation of these entities, which, in other respects, are also subject to regulation by ASIC.

As part of its supervisory activities, as summarised in *The APRA Supervision Blueprint* (January 2010), APRA has issued a number of prudential standards, which focus on matters affecting directors and boards of regulated financial services entities. The APRA approach in the prudential standards is more prescriptive than that taken by ASIC on matters of governance, though it is confined to the limited range of corporations, being banks and other financial institutions for which it is responsible.

Prudential Standard APS 510 *Governance* sets out minimum requirements for good governance of deposit-taking institutions. It points out that the ultimate responsibility for their sound and prudential management rests with the board of directors. It is essential that deposit-taking institutions have a sound governance framework and conduct their affairs with a high degree of integrity. The Prudential Standard:

aims to ensure that [these] institutions are managed in a sound and prudent manner by a competent Board of directors, which is capable of making reasonable and impartial business judgements in the best interests of the regulated institution and which gives due consideration to the impact of its decisions on depositors.

The Standard contains a series of requirements concerning the composition and conduct of boards, and board committees, of these entities, including:

- requirements with respect to board size and composition
- the chair of the board must be an independent director
- a board audit committee must be established
- the entity must have a dedicated internal audit process

- the board must have a remuneration policy that aligns remuneration and risk management
- a board remuneration committee must be established
- the board must have a policy on board renewal and procedures for assessing board performance.

Prudential Standard APS 520 *Fit and Proper* and *Prudential Practice Guide APG 520 Fit and Proper* (July 2008) deal with directors and other persons who are responsible for the management and supervision of deposit-taking institutions. The Standard sets out requirements for these institutions directed to the fitness and propriety of directors and others in a managerial position ('responsible persons'), including that institutions must:

- have and implement a fit and proper policy that meets the requirements of the prudential standard
- generally assess the fitness and propriety of a responsible person, prior to initial appointment and annually
- take all prudent steps to ensure that a person appointed is not appointed to, or does not continue to hold, a responsible person position for which that person is not fit and proper
- provide APRA with certain information regarding each responsible person and the institution's assessment of that person's fitness and propriety.

APRA has issued similar prudential standards and practice guides for general insurers and life companies.

### 3.4.3 Takeovers Panel

The Takeovers Panel is a peer review body that regulates corporate control transactions in widely held Australian entities, primarily by the resolution of takeover disputes.<sup>26</sup> It has various statutory powers,

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<sup>26</sup> The Takeovers Panel is established under Part 10 of the ASIC Act.

including to make declarations of unacceptable circumstances and subsequent orders.<sup>27</sup>

The Panel has issued a series of guidance notes for participants in takeover bids, including directors of bidder and target companies. This includes Guidance Note 19 *Insider Participation in Control Transactions*, which deals with situations where a director, manager or external adviser of a target company has an involvement with the bidder.

### 3.5 ASX Corporate Governance Council

#### 3.5.1 Corporate governance concepts

The Australian Securities Exchange Corporate Governance Council (ASX Council), formed in 2002, comprises representatives of various business and industry bodies and investment and shareholder groups, and is convened by the ASX.

The ASX Council published its *Corporate Governance Principles and Recommendations* in March 2003, which set out guidance for listed companies in Australia. In 2007, it published a second edition of these principles and recommendations, taking into account subsequent legislative amendments, trends observed through the ASX's annual survey of reporting and Australian and overseas developments in corporate governance, including in relation to non-financial risk reporting.

The ASX document sets out eight Principles, applicable to all listed entities, with various Recommendations under each Principle on ways to implement the Principle.

The Principles 'embody the broad concepts which underpin effective corporate governance. They encapsulate "common sense" ideas with broad relevance'.<sup>28</sup> The Principles are:

- *Principle 1—Lay solid foundations for management and oversight*

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<sup>27</sup> Corporations Act Part 6.10 Division 2.

<sup>28</sup> ASX Corporate Governance Council *Corporate Governance Principles and Recommendations* (2<sup>nd</sup> edition, 2007) at 6.

Companies should establish and disclose the respective roles and responsibilities of board and management.

- *Principle 2—Structure the board to add value*

Companies should have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.

- *Principle 3—Promote ethical and responsible decision-making*

Companies should actively promote ethical and responsible decision-making.

- *Principle 4—Safeguard integrity in financial reporting*

Companies should have a structure to independently verify and safeguard the integrity of their financial reporting.

- *Principle 5—Make timely and balanced disclosure*

Companies should promote timely and balanced disclosure of all material matters concerning the company.

- *Principle 6—Respect the rights of shareholders*

Companies should respect the rights of shareholders and facilitate the effective exercise of those rights.

- *Principle 7—Recognise and manage risk*

Companies should establish a sound system of risk oversight and management and internal control.

- *Principle 8—Remunerate fairly and responsibly*

Companies should ensure that the level and composition of remuneration are sufficient and reasonable and that its relationship to performance is clear.

The Recommendations for practice under each Principle provide a ‘framework for implementing the Principles within an

organisation'.<sup>29</sup> The recommendations are not required to be followed. Boards of listed entities may choose not to adopt particular Recommendations if they consider them unsuitable for the company's situation. Under the listing rules each listed entity is obliged to provide in its annual report a statement of the extent to which it has followed the Recommendations in the reporting period, with a further obligation, where it has not followed particular Recommendations, to provide reasons for not having done so (the 'if not, why not' approach).<sup>30</sup> In this way, directors and boards of listed entities are, in effect, required at least to consider the governance matters set out in the Recommendations, even if they choose not to adopt them in various respects.

This reporting approach to guidance for boards of listed entities is modelled on the general approach taken in the UK *Combined Code on Corporate Governance* (see further Section 4.2.2).

The ASX publishes periodic reviews of levels of compliance with the ASX Corporate Governance Council *Principles and Recommendations*.<sup>31</sup>

The document setting out the *Principles and Recommendations* also contains a list of references for further information on matters referred to by the ASX Council.

### 3.5.2 Guidance for directors

The Recommendations include limited guidance for non-executive as well as executive directors on their role and what is expected of them:

- *board composition*: a majority of the board should be independent directors, being persons who are non-executive directors (that is, directors who are not members of management) and who are also free of any business or other relationship that could materially interfere with the independent exercise of their judgment. Directors considered by the board to be independent should be identified as such in the corporate

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<sup>29</sup> *ibid.*

<sup>30</sup> ASX Listing Rule 4.10.3.

<sup>31</sup> See *Analysis of Corporate Governance Disclosures in Annual Reports for year ended 31 December 2008* (August 2009).

governance statement in the annual report. The board should regularly assess, against recommended criteria, whether each non-executive director is independent<sup>32</sup>

- *board induction:* all new directors should clearly understand corporate expectations of them, through formal letters of appointment setting out the key terms and conditions relevant to their appointment<sup>33</sup> and through induction and continuing education programs<sup>34</sup>
- *board responsibilities:* all directors, acting collectively as the board, are responsible for a range of matters, including reviewing the performance of management, and overseeing the systems of financial reporting, risk management and other internal controls<sup>35</sup>
- *board decision-making:* All directors—whether independent or not—should bring an independent judgment to bear on board decisions. Non-executive directors should consider the benefits of conferring regularly without management present, including at scheduled sessions<sup>36</sup>
- *seeking professional advice:* To facilitate independent decision-making, there should be a procedure agreed by the board of directors to have access in appropriate circumstances to independent professional advice at the company's expense<sup>37</sup>
- *chair:* the chair should be an independent director<sup>38</sup>
- *nomination committee:* the board nomination committee should consist of a majority of independent directors and be chaired by an independent director<sup>39</sup>
- *election and re-election:* persons seeking election or re-election as non-executive directors should provide details to the

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<sup>32</sup> Recommendation 2.1 and Commentary and Guide to reporting on Principle 2.

<sup>33</sup> Commentary on Recommendation 1.1 and Box 1.1.

<sup>34</sup> Commentary on Recommendation 2.5.

<sup>35</sup> Commentary to Recommendation 1.1; also Recommendations 4.1 and 7.2.

<sup>36</sup> Commentary on Recommendation 2.1.

<sup>37</sup> *ibid.*

<sup>38</sup> Recommendation 2.2.

<sup>39</sup> Commentary on Recommendation 2.4.

nomination committee of their other commitments and an indication of the time involved. They should also specifically acknowledge to the company that they will have sufficient time to meet what is expected of them. Non-executive directors should also inform the chair of the board and the chair of the nomination committee before accepting any other appointments as directors<sup>40</sup>

- *audit committee*: the board audit committee should consist only of non-executive directors, with a majority being independent directors, and be chaired by an independent director who is not also chair of the board<sup>41</sup>
- *remuneration committee*: the remuneration committee of the board should consist of a majority of independent directors and be chaired by an independent director<sup>42</sup>
- *remuneration of non-executive directors*: companies should clearly distinguish the structure of non-executive directors' remuneration from that of executive directors and senior executives.<sup>43</sup>

### 3.6 Inquiries and other reports

Royal Commissions and other inquiries have been established from time to time to examine particular company failures and their causes. Their reports often include more general observations on governance issues. Likewise, other reports on issues of public concern may raise matters concerning aspects of corporate governance, or propose changes in approach. In this way, inquiries and reports provide guidance for directors and boards on matters affecting their governance role and responsibilities, and possible future developments.

The Royal Commission into HIH Insurance, as well as canvassing the causes of the failure of that company and seeking to identify fault or responsibility, put forward views on approaches to corporate

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<sup>40</sup> *ibid.*

<sup>41</sup> Recommendation 4.2.

<sup>42</sup> Commentary on Recommendation 8.1.

<sup>43</sup> Recommendation 8.2 and Box 8.2.

governance. More recently, the Productivity Commission in its inquiry into executive remuneration canvassed questions of accountability and board practice in relation to executive remuneration.

### 3.6.1 HIH Royal Commission report

The HIH Royal Commission report *The failure of HIH Insurance* (2003) pointed to effective corporate governance practices as ways for directors to fulfil their stewardship and accountability obligations:

Viewed at a high level, corporate governance is all about accountability and stewardship. The funds and assets that a corporation collects are to be held and grown for the ultimate benefit of those who have a stake in the success of the business. Those in whom responsibility is vested to control and direct the business have stewardship of those funds and are accountable for them. One critical objective of a system of corporate governance is to ensure that those people hold the confidence of those having a stake in the success of a business.<sup>44</sup>

The report provides guidance on some of the key elements in promoting an effective corporate governance structure, including:

- *concept of an independent director*: ‘An independent director needs to be engaged with the company—in terms of being an inside participant—but free of impediment to the exercise of objectivity of judgment. ... It is customary to speak of “independent directors” but I think this gives the wrong emphasis. What is required is independent judgment. The distinction is subtle but important ... an attempt to be unduly prescriptive might impose undesirable rigidity, and distract attention from the critical issue of freedom from possible influences, many of which may be subtle and not susceptible to a “check-list” approach.’<sup>45</sup>
- *collective responsibility of board members*: ‘They [the board members] must work together and bring to bear their collective

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<sup>44</sup> HIH Royal Commission report *The failure of HIH Insurance* (2003) Volume 1 at 103.

<sup>45</sup> id at 112-113.

ability to provide both the leadership and the checks and balances that corporate governance demands. Although some directors may have particular responsibilities for which they are accountable to the board, it is for the board collectively to ensure that it is meeting its obligations.’<sup>46</sup>

- *role of the chair*: ‘The chair should have the steering hand on the proceedings of the board. During the deliberations of the board, the chair must ensure that the views of all directors are heard and not stifled by the conduct of others. This can be promoted by the chair’s control of any who impede the full and frank exchange of views. He or she must ensure that board meetings achieve the purposes for which they are intended. They should provide an open forum at which executives report and directors discuss with candour the company’s position, performance and prospects. The chair needs to ensure that this is not done in a fashion which discourages the frank disclosure of bad news, doubts or fears.’<sup>47</sup>
- *role of non-executive directors*: ‘It is incumbent on non-executive directors to understand the nature of the company’s business regardless of their own particular expertise or experiences. They need to attain a working grasp of the essential drivers of the business, the competitive environment and the nature of the risks to be managed. In this way, they will be equipped to carry out a role of critical and constructive inquiry, review and support.’<sup>48</sup>
- *effective decision-making*: ‘... too much attention can be directed to the desired characteristics of the board and not enough to the more difficult and important question whether the board is working effectively together—not only to comply with the plethora of laws and “best practices” that exist, but also to get on with its most important job of leading a viable, profitable and efficient corporation.’<sup>49</sup>
- *board review*: ‘Part of the board’s responsibility therefore is to keep its own composition and effectiveness under review. ... A

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<sup>46</sup> id at 107.

<sup>47</sup> id at 109.

<sup>48</sup> id at 110.

<sup>49</sup> id at 112.

process by which a board reviews its own performance as well as the effectiveness of its processes should be part and parcel of a board cycle of reviews of the company and its business. ... The review should include detailed consideration of the effectiveness of the current corporate governance model. Any ways in which it has failed or could work better should be addressed.<sup>50</sup>

The report also observed that effective corporate governance practices, while of key importance, are not ends in themselves but are elements in a broader context of board and corporate performance:

In reviewing its own governance practices, a board should bear in mind that corporate governance is a means to an end and not an end in itself. The end which good governance serves is the advancement of the company as a whole, for the benefit of its shareholders and the wider community. Success in that endeavour cannot be measured merely by reference to principles of governance, but in the wider context of the company's performance as a business enterprise—its profits, efficiency, viability, innovation and so on. These are the goals at which good corporate governance should be directed. Progress towards those goals should be a key part of any board review.<sup>51</sup>

### 3.6.2 Productivity Commission report

The Productivity Commission Inquiry report *Executive Remuneration in Australia* (December 2009) considered the role of the board in setting executive remuneration. It referred to the perceived problem of captured or incompetent boards permitting excessive remuneration arrangements that appear inconsistent with a reasonably efficient executive labour market or contain perverse incentives that could weaken company performance. It observed that:

Executive remuneration outcomes also provide a window on board performance more broadly, with apparent board 'failure' fomenting disquiet among investors and the

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<sup>50</sup> id at 117-118.

<sup>51</sup> id at 118.

community more broadly, potentially sapping confidence and trust in equity markets.<sup>52</sup>

The report included various recommendations for regulatory initiatives in regard to executive remuneration. These included a proposal for a ‘two strikes’ rule whereby, if a company’s remuneration report is objected to at two annual general meetings by at least a quarter of the eligible votes cast, the directors who signed the report must commence a process for their re-election. The Government has since indicated that it has accepted the bulk of recommendations in the Productivity Commission report, including the ‘two strikes’ proposal.<sup>53</sup>

The report proposed various practical steps to make boards more accountable in the setting of executive pay, including avoiding conflicts of interest by:

- strengthening requirements for the establishment of remuneration committees, the independence of their membership and their interaction with company executives, particularly for the [ASX] top 300 companies
- requiring remuneration consultants to report directly to the board or remuneration committee (without constraining scope for them to consult with management)
- disclosure in remuneration reports of the use of remuneration consultants.<sup>54</sup>

The report observed that these proposed changes to board practice, and other proposed corporate governance reforms:

may require boards to pay more attention to executive remuneration than some have done in the past. In the Commission’s view, this is called for and will complement rather than compete with other key board responsibilities. Appropriate remuneration structures for executives not only reflect on board competence, but are integral to the

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<sup>52</sup> The Productivity Commission Inquiry Report *Executive Remuneration in Australia* (December 2009) at xxvi.

<sup>53</sup> Joint Treasury Media Release No. 033 of 16 April 2010 *Government responds to the Productivity Commission report on executive remuneration*.

<sup>54</sup> id at xxix.

successful implementation of corporate strategies and thus the creation of shareholder wealth.<sup>55</sup>

The report also made best practice recommendations for disclosure about executive remuneration, namely that remuneration reports should include:

- a plain English summary statement of companies' remuneration policies
- actual levels of remuneration received by the individuals named in the report
- total company shareholdings of the individuals named in the report.

The Government has indicated that it will ask CAMAC to review various matters coming out of the Productivity Commission report.

### 3.7 Private initiatives and services

#### 3.7.1 Companies

Some boards provide guidance to their directors, including through induction programs for new directors and ongoing programs for all directors. They draw on their own resources as well as outside advisers and consultants.

The ASX Council, in the context of discussing Principle 1 of its *Corporate Governance Principles and Recommendations*, points out that it is appropriate that directors of listed entities clearly understand the corporate expectations of them. These expectations can be set out in formal letters of appointment of directors. Companies might choose to include information on the role, powers, duties and terms and conditions of appointment of directors and the company's expectations of them, as well as information on the company's strategic plan, internal culture, codes of conduct, system of governance (including board practices), risk management and compliance framework and overall financial situation. Various of these matters are set out in Box 1.1 of the *Corporate Governance*

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<sup>55</sup> id at xxxiii.

*Principles and Recommendations.* Also, Recommendation 3.1 of these *Principles and Recommendations* states that listed companies should establish a code of conduct, with Box 3.1 setting out the suggested content of the code, affecting directors as well as other officers, and with the board giving a clear commitment to its implementation.

A board may also have a policy of promoting director knowledge of, and engagement with, its affairs in various ways, including by holding board meetings in different company locations, arranging for directors to visit the various sites that the company operates and facilitating discussions between directors, company executive staff and other employees.

### **3.7.2 Professional and industry bodies**

Directors and advisers to boards can also gain assistance from guidance products and services offered by professional and industry bodies and other sources. Some of these products and services are directed to legal compliance issues, while others address broader aspects of governance and behavioural issues affecting director and board effectiveness. A notable early work in this area was F Hilmer, *Strictly Boardroom: improving governance to enhance company performance* (1993), with subsequent work including H Bosch, *Conversations with a new director* (1997).

Professional and industry bodies have various incentives to offer guidance, including to establish or maintain their standing and reputation in the corporate community as providers of well-informed and practical advice for use by directors and boards.

Bodies providing guidance to directors and boards include the Australian Institute of Company Directors (AICD), Chartered Secretaries Australia (CSA), the Investment and Financial Services Association Limited (IFSA), the Australian Council of Superannuation Investors (ACSI), the Australian Shareholders' Association (ASA) and CPA Australia. Much of the guidance provided by these bodies is publicly available, free of charge in some cases, while some guidance is available only to members of the body in question.

## AICD

The Australian Institute of Company Directors publishes periodicals and books, conducts courses for new or current directors, and holds conferences, events and other activities on matters relevant to the role of directors. The *Company Director* is a monthly magazine for AICD members, with regular columns on current legal and business issues, while *The Boardroom Report*, *Director Update* and *Director Alerts* are email newsletters to members covering recent news and emerging issues. Books published by, or available through, the AICD cover a broad range of matters relevant to directors and boards of commercial and not-for-profit entities. Courses conducted by the AICD range from general orientation courses for first-time directors to tailored courses for directors in particular applied areas. The AICD provides *Online Information Guides* and a *Frequently Asked Questions* service for its members, as well as holding *Directors Briefings* and conducting *Directing Tomorrow Today* seminars on a range of topical matters for directors.

The AICD has a range of products and services, and mentoring and coaching programs, including the *Director Advisory Service* and *Director Nexus*, to assist directors to understand the day to day practice of directorship. It conducts peer discussion groups, such as the *Chairman's Forum* and the *ASX Roundtable Series*, to promote the interchange of views on relevant issues by chairs and directors of ASX 200 companies and also as a means of gathering views and information that can be incorporated into AICD policies and guidance that it provides to its members and to directors generally. It undertakes research on matters affecting directors, including through surveys of its members and research, such as *Directors Social Impact Study* (February 2010), which deals with not-for-profit directors. Further details of publications, courses and other services available through the AICD are set out in Appendix 2.

## CSA

Chartered Secretaries Australia focuses on corporate governance and risk management practices and issues. CSA conducts a range of educational and training courses, with tailored public, not-for-profit and private sector subject options. It publishes the periodical *Keeping good companies*, which deals with a range of corporate governance issues. CSA issues publications on various aspects of corporate governance, including a series of *Good Governance Guides* for listed entities, non-listed companies and public sector

entities. These courses, publications and guides cover a broad range of matters relevant to directors, including the functioning of boards and board committees. Further details of publications and courses available through the CSA are set out in Appendix 3.

### **IFSA**

The Investment and Financial Services Association, a funds management industry body, publishes *Corporate Governance: A Guide for Fund Managers and Corporations* (the 'Blue Book'), which includes an analysis of what institutional investors expect of directors in regard to corporate governance structures. It is designed:

to assist [IFSA's members] to pursue an active role in monitoring the Corporate Governance responsibilities of the companies in which they invest.<sup>56</sup>

The IFSA guidelines are designed to complement the ASX Corporate Governance *Principles and Recommendations*. Areas covered include:

- board composition
- board committees (nomination committee, audit committee, remuneration committee)
- election of directors
- appointment and equity participation of non-executive directors
- respective roles of the board and management
- trading by directors and senior management
- performance evaluation
- board and executive remuneration policy and disclosure.

The IFSA Blue Book also contains guidelines for fund managers to follow in engaging with companies in which they invest. These guidelines, which may be instructive for directors of investee companies, include:

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<sup>56</sup> Section 7.1.

- *communication with companies:* Fund Managers should establish direct contact with companies in accordance with their Corporate Governance Policy. Engagement with companies should include constructive communication with both senior management and board members about performance, corporate governance and other matters affecting shareholders' interests<sup>57</sup>
- *voting on company resolutions:* Fund Managers should vote on all Australian company resolutions where they have the voting authority and responsibility to do so. An aggregate summary of a Fund Manager's Australian proxy voting record must be published at least annually and within two months of the end of the financial year<sup>58</sup>
- *environmental and social issues and corporate governance:* Fund Managers should engage companies on significant environmental and social issues that have the potential to impact on current or future company reputation and performance.<sup>59</sup>

### ACSI

The Australian Council of Superannuation Investors provides research and advice to superannuation funds on the environmental, social and governance risks of companies in which they invest. ACSI considers that 'good governance' requires directors of listed companies to consider and manage all of those risks. ACSI publishes various guidelines that provide superannuation fund managers with benchmarks to assess the relevant practices of companies in which they invest.

### ASA

The Australian Shareholders Association publishes position statements of its views on various corporate practice, governance and disclosure issues concerning directors and boards. The statements include director remuneration, margin loans to directors and non-executive directorships. The Association has also published research on workloads for non-executive directors.

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<sup>57</sup> Guideline 2.

<sup>58</sup> Guideline 3.

<sup>59</sup> Guideline 5.

### **CPA Australia**

CPA Australia, in conjunction with Cameron Ralph Pty Ltd, has produced a guide for persons contemplating a non-executive directorship on a board or committee in the corporate, not-for-profit or public sectors *Finding the right Board for you: 10 Questions to ask before joining a Board*. The questions go to:

- the business of the company
- its current financial position
- the legal and regulatory environment in which the company operates
- the quality of the information to directors
- the composition of the board
- the reasons why the board needs a new director and what the board is looking for in a director
- the control structure, including the identity of shareholders and stakeholders
- the contribution that the new director can make
- the capacity of the new director to undertake the role.

### **Other bodies**

Other bodies, including the Law Council of Australia, the Insolvency Practitioners Association, the Commercial Lawyers Association, the Institute of Chartered Accountants and the National Institute of Accountants conduct seminars and conferences on matters relevant to corporate governance. The Australian Centre for Corporate Governance provides information on legal and other developments relevant to directors and boards and seeks to promote dialogue in corporate governance matters.

### **3.7.3 Peer guidance**

Directors can gain guidance on issues affecting them individually and collectively as a board from the views of other directors. This can include formal or informal leadership or mentoring programs

whereby experienced directors are available, in a general forum or on a confidential basis, to discuss issues, and the promotion of peer support and other formal and informal networks between directors. For instance, as indicated above (Section 3.7.2), the AICD conducts peer discussion groups, such as the *Chairman's Forum* and the *ASX roundtable series*, and provides other peer guidance through the *Director Advisory Service*, *Director Nexus* and mentoring/advice services.

The annual survey *Board effectiveness: The directors cut* (Deloitte) is based on interviews with over 200 board chairs and directors from the top 200 ASX companies. It identifies factors and influences that respondents consider affect board performance, thereby providing a means for chairs and directors to compare themselves with their peers, both individually and as a board. It summarises how surveyed directors view individual and collective board performance, sets out their views on measurement and evaluation of performance, including how to make a board a high performing team, and identifies what directors consider are current and emerging trends and issues for boards. The 2009 report drew attention to various matters of concern to directors and observed that:

It is clear ... that there is a diverse range of perspectives on the way boards should operate and an even greater diversity of practice.<sup>60</sup>

The periodic study *Board of Directors Study Australia and New Zealand* (Korn/Ferry International and Egan Associates) sets out areas of corporate governance that directors of listed entities identify as being of concern. The key concerns in 2009 centred on:

- CEO succession
- risk management
- non-executive director selection
- challenges of boards and board remuneration committees.<sup>61</sup>

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<sup>60</sup> Deloitte Board effectiveness website.

<sup>61</sup> at 2-7.

### 3.7.4 Other guidance

There is a range of other bodies and individuals offering consultative and advisory services to directors and boards on corporate governance matters. They include legal and accounting firms as well as boardroom and human resources consultants. Their advice can range from guidance on general board governance issues, to comprehensive reviews and evaluations of chair, individual director and board requirements and performance.

Other bodies, including the St James Ethics Centre, focus on providing guidance to directors and others on issues relating to business ethics and the social responsibility of companies. These broader environmental and social factors are also monitored by various institutional investors.<sup>62</sup>

Various consultants publish lists of publications, presentations and other information relevant to directors and boards, including links to other bodies dealing with corporate governance matters in Australia or elsewhere.

In addition to publications available through professional and industry bodies, there is a range of publications on legal, organizational and other matters concerning the functions of boards and the duties, powers and responsibilities of directors. These include general works on corporate law and corporate finance, as well as publications that focus on legal issues specifically affecting directors, such as:

- R Austin, H Ford & I Ramsay, *Company directors: principles of law and corporate governance*
- R Baxt, *Duties and responsibilities of directors and officers*
- J Farrar, *Corporate governance: theories, principles and practice*.

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<sup>62</sup> Regnan describes itself as representing various institutional investors ‘who recognise that environmental, social and corporate governance (ESG) factors affect long term shareholder returns. Regnan promotes strengthened ESG performance within the S&P/ASX200 companies in which these institutions invest.’

There are also publications on behavioural as well as structural factors in achieving effective director and board performance, building on work such as F Hilmer, *Strictly Boardroom: improving governance to enhance company performance* (1993, with a second edition in 1998), *Corporate Practices and Conduct* (a booklet published in 1995 by a committee of representatives of business and professional bodies, chaired by Henry Bosch AO) and H Bosch, *Conversations with a new director* (1997), as well as more recent contributions in this area such as C Carter & J Lorsch, *Back to the drawing board: designing corporate boards for a complex world* (2004).

Professional and industry bodies conduct research relevant to directors and boards. The biannual *Non-executive directors' survey report* (ProNed) provides data and analysis on governance issues, such as board appointment, composition and director remuneration. It includes sections surveying chairs and non-executive directors by type of company, turnover and industry.

The UTS Centre for Corporate Governance has conducted qualitative survey research on aspects of corporate governance, including *The changing roles of company boards and directors* (2007).

Legal issues relevant to boards and directors, and guidance on how they might be dealt with, are addressed by contributors to law journals, including:

- *Company and Securities Law Journal*
- *Australian Journal of Corporate Law*
- *Insolvency Law Journal*.

Other periodicals include CCH *Across the Board* and *Australian Corporate News* and LexisNexis *Butterworths Corporation Law Bulletin*.

A number of academic institutions publish information and conduct public seminars on matters of concern to directors and boards. They include the Centre for Corporate Law and Securities Regulation (University of Melbourne), whose stated purpose is to undertake research on corporate law, corporate governance and securities

regulation and to provide a focal point for those working in these areas. Likewise, the Ross Parsons Centre of Commercial, Corporate and Taxation Law (University of Sydney) promotes a range of conferences, seminars and publications, including on topical issues for directors, such as *Directors in troubled times* (Monograph 7, 2009).

Other universities and institutions conduct seminars and continuing legal education courses on matters concerning directors, their advisers and other interested persons. In the not-for-profit area, the Australian Centre for Philanthropy and Nonprofit Studies (Queensland University of Technology) makes information available through publications, seminars and other means to persons involved in non-profit bodies.

Various commercial bodies promote seminars on legal, accounting and other issues of relevance to the functions and duties of directors.



## 4 Guidance available overseas

*This chapter looks at guidance that is available in other countries to assist directors to understand and fulfil their role.*

### 4.1 Introduction

The Committee has reviewed published information about guidance to directors in the United Kingdom and in North America. It has also had regard to international guidance standards.

### 4.2 United Kingdom

Guidance to executive and non-executive directors on their role and responsibilities is provided through various means, including:

- legislative direction
- the UK *Combined Code on Corporate Governance*
- relevant reports
- code for institutional shareholders
- private sector guidance.

#### 4.2.1 Companies legislation

The UK *Companies Act 2006* covers a range of matters affecting directors and boards, including the introduction of statutory duties on directors of UK incorporated companies.<sup>63</sup> Various summaries and commentaries on these provisions have been published, including *Companies Act 2006: Duties of company directors* (2007),<sup>64</sup> which provides background information on the provisions and contains brief guidance points on what directors should do to comply with their statutory obligations.

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<sup>63</sup> UK *Companies Act 2006*, Part 10.

<sup>64</sup> Ministerial statements, Department of Trade and Industry, June 2007.

## 4.2.2 The Corporate Governance Code

### *Current Code*

The first version of what became the UK *Combined Code on Corporate Governance* (from June 2010, to be called *The UK Corporate Governance Code*) (the Code) was produced in 1992 by the Cadbury Committee in its *Report of the Committee on the Financial Aspects of Corporate Governance*.

The Code was first published in 1998 and has been revised in 2003, 2006 and 2008. Its original and subsequent content has been influenced by the Cadbury Committee report and a series of other reports, including *Internal Control and Financial Reporting* (Rutteman Report) (1994), *Directors' Remuneration* (Greenbury Report) (1995), *Corporate Governance* (Hampel Report) (1998), and *Review of the role and effectiveness of non-executive directors* (Higgs Report) (2003).

The Higgs Report considered a range of issues concerning the effectiveness of boards and the role of the non-executive director. It focused on matters going beyond compliance, including the benefits of companies introducing pre-appointment and due diligence checklists for new board members, providing explanatory letters to new board appointees and developing induction and performance evaluation guidance. In the preparation of the report, qualitative research was undertaken on the skills and behaviour needed for an individual to work effectively as a non-executive director.<sup>65</sup>

The Code seeks to promote good corporate governance and appropriate board behaviour for UK listed entities, in the belief that this will assist the long-term success of these companies. It is a single Code for all UK listed companies, without sector-specific provisions.

The Code consists of principles (main and supporting), which set the context in which directors and boards are to operate, and provisions to implement the principles. The Code is implemented through London Stock Exchange listing rule reporting requirements. Listed

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<sup>65</sup> See, for instance, T McNulty, J Roberts, P Stiles, *Creating accountability within the board: The work of an effective non-executive director*.

companies are required to describe in their annual reports their corporate governance practices from two perspectives:

- how they have adhered to the Code's principles, and
- non-compliance with any of the Code provisions.

Companies that consider that one or more of the Code provisions are inappropriate for their situation may adopt a different approach, though in those circumstances they must clearly explain to shareholders why they have reached that view (the 'comply or explain' requirement). This compares with the ASX Corporate Governance Council approach, which adopts an 'if not, why not' requirement for the Recommendations under each of its Principles (see Section 3.5).

The Code is the responsibility of the UK Financial Reporting Council (FRC), which 'is the UK's independent regulator responsible for promoting confidence in corporate governance and reporting'. The FRC focuses on setting standards for companies, but does not itself monitor or enforce their implementation, which is done through the exchange listing rules compliance mechanism. The Chair and Deputy Chair of the FRC board are appointed by the UK Government, with other members drawn from the private sector and other areas. The FRC has a number of operating bodies, including the Committee on Corporate Governance, whose terms of reference include:

- to keep under review developments in corporate governance generally
- to monitor the operation of the Code and its implementation by listed companies and shareholders, and
- where significant doubts are raised about the appropriate interpretation of part of the Code, to consider the case for issuing a clarification, and if appropriate to do so, after any suitable consultation.

The FRC has provided guidance on the Code and related matters in various publications, including *Guidance on Audit Committees (The Smith Guidance)* (2005), *Internal Control: Revised Guidance for*

*Directors on the Combined Code (2005), and Going concern and liquidity risk: guidance for directors of UK companies (2009).*

The current version of the Code has operated since June 2008. It covers a range of governance issues for listed entities, including matters concerning:

- the appointment, role, re-election and evaluation of directors
- the composition, functions and evaluation of boards
- the role of the chair
- the structure and operation of audit and other board committees
- the relationship between the board and the executive
- communication between the board and shareholders
- remuneration policies
- market disclosure.

### ***Guidance for directors***

The Code includes guidance for directors, including non-executive directors, on their role and what is expected of them:

- *board composition:* The board should include a balance of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking. To ensure that power and information are not concentrated in one or two individuals, there should be a strong presence on the board of both executive and non-executive directors.

The board should identify in the annual report each non-executive director it considers to be independent. The board should determine whether the director is independent in character and judgment and whether there are relationships or circumstances that are likely to affect, or could appear to affect, the director's judgment. The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances that may appear

relevant to its determination. Except for smaller companies, at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. A smaller company should have at least two independent non-executive directors.

- *board induction*: The terms and conditions of appointment of non-executive directors should be made available for inspection. The letter of appointment should set out the expected time commitment. Non-executive directors should undertake that they will have sufficient time to meet what is expected of them. Their other significant commitments should be disclosed to the board before appointment, with a broad indication of the time involved and the board should be informed of subsequent changes.

The chairman should ensure that new directors receive a full, formal and tailored induction on joining the board.

Non-executive directors should themselves undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company.

- *board responsibilities and decision-making*: As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy. Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible. They are responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointing, and where necessary removing, executive directors, and in succession planning.
- *senior independent director*: The board should appoint one of the independent non-executive directors to be the senior independent director. The senior independent director should be available to shareholders if they have concerns that contact through the normal channels of chairman, chief executive or

finance director has failed to resolve or for which such contact is inappropriate<sup>66</sup>

- *seeking professional advice:* The board should ensure that directors, especially non-executive directors, have access to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities as directors.

Non-executive directors should themselves seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice.

- *chair:* The chairman should hold meetings with the non-executive directors without the executives present. Led by the senior independent director, the non-executive directors should meet without the chairman present at least annually to appraise the chairman's performance and on such other occasions as are deemed appropriate. The chairman should also facilitate the effective contribution of non-executive directors in particular and ensure constructive relations between executive and non-executive directors.
- *evaluation of the chair:* The non-executive directors, led by the senior independent director, should be responsible for performance evaluation of the chairman, taking into account the views of executive directors<sup>67</sup>
- *contact with major shareholders:* The company should offer to major shareholders the opportunity to meet a new non-executive director. Non-executive directors should be offered the opportunity to attend meetings with major shareholders and should expect to attend them if requested by major shareholders. The senior independent director should attend sufficient meetings with a range of major shareholders to listen to their views in order to help develop a balanced understanding of the

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<sup>66</sup> There is no equivalent of the concept of senior independent director in the ASX Corporate Governance Council *Principles and Recommendations*.

<sup>67</sup> There is no equivalent provision in the ASX Corporate Governance Council *Principles and Recommendations*. Instead, Recommendation 2.5 in that document refers to companies disclosing the process for evaluating the performance of the board and individual directors.

issues and concerns of major shareholders. The board should state in the annual report the steps they have taken to ensure that the members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders about their company, for example through direct face-to-face contact, analysts' or brokers' briefings and surveys of shareholder opinion<sup>68</sup>

- *director concerns:* Where directors have concerns about the running of the company or a proposed action, they should ensure that these concerns are addressed by the board and, to the extent that they are not resolved, ensure that they are recorded in the board minutes. On resignation, a non-executive director should provide a written statement to the chairman, for circulation to the board, if he or she has any unresolved concerns<sup>69</sup>
- *nomination committee:* There should be a nomination committee, which should lead the process for board appointments and make recommendations to the board. A majority of members of the nomination committee should be independent non-executive directors. The chairman or an independent non-executive director should chair the committee.
- *election and re-election:* Non-executive directors should be appointed for specified terms subject to re-election and to Companies Acts provisions relating to the removal of a director. The board should set out to shareholders in the papers accompanying a resolution to elect a non-executive director why they believe an individual should be elected. The chairman should confirm to shareholders when proposing re-election that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role. Any term beyond six years (for instance, two three-year terms) for a non-executive director should be subject to particularly rigorous review, and should take into account the need for progressive refreshing of the

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<sup>68</sup> There is no equivalent provision in the ASX Corporate Governance Council *Principles and Recommendations*. Instead, Recommendation 6.1 in that document refers to companies promoting effective communication with shareholders.

<sup>69</sup> There is no equivalent of this discussion in the ASX Corporate Governance Council *Principles and Recommendations*.

board. Non-executive directors may serve longer than nine years (e.g. three three-year terms), subject to annual re-election. Serving more than nine years could be relevant to the determination of a non-executive director's independence

- *audit committee*: The board should establish an audit committee of at least three, or in the case of smaller companies two, independent non-executive directors. In smaller companies the company chairman may be a member of, but not chair, the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman.
- *remuneration committee*: The board should establish a remuneration committee of at least three, or in the case of smaller companies two, independent non-executive directors.
- *remuneration of non-executive directors*: Levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role. Remuneration for non-executive directors should not normally include share options.

The board itself or, where required by the articles of association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the articles. Where permitted by the articles, the board may however delegate this responsibility to a committee, which might include the chief executive.

### *Proposed amendments to the Code*

The FRC initiated a review of the Code in 2009. One thrust of the review, which at the time of this report is ongoing, is on personal and inter-personal behavioural factors in achieving director and board effectiveness. The FRC has proposed that the Code include the following new or amended guidance principles:<sup>70</sup>

- *long-term focus*. Every company should be headed by an effective board, which is collectively responsible for the long-term success of the company

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<sup>70</sup> FRC 2009 *Review of the Combined Code: Final Report* (December 2009); *Consultation on the Revised UK Corporate Governance Code* (December 2009).

- *selection of directors.* Appointments to the board should be made on merit and against objective criteria that do not inappropriately restrict the talent pool from which candidates will be identified
- *duties of directors.* All directors are fiduciaries who must act objectively in the best interests of the company and in accordance with their statutory duties
- *the commitment levels expected of directors.* All directors must be able to allocate sufficient time to the company to perform their responsibilities effectively
- *director development.* To function effectively, all directors need appropriate knowledge of the company and access to its operations and staff. Directors should be offered the opportunity to meet major shareholders. The chair and each director should agree on and regularly review a personalised approach to training and development of that director
- *balance and composition of board and committees.* The board and its committees should consist of directors with the appropriate balance of skills, experience, independence and knowledge of the company to enable the company to discharge its duties and responsibilities effectively
- *the role of the chair.* The chair is responsible for leadership of the board and ensuring its effectiveness. The chair must ensure that adequate time is available for discussion of strategic issues, and should promote a culture of openness and debate. The chair should also ensure that all directors understand the issues and concerns of the company's major shareholders
- *role of non-executive directors.* As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy. The board should appoint one of the independent non-executive directors to be the senior independent director to provide a sounding board for the chairman and to serve as an intermediary for the other directors when necessary
- *risk management and internal controls.* The board is responsible for defining the company's risk appetite and tolerance. It should

also satisfy itself that the company has appropriate systems to identify, evaluate and manage the significant risks it faces. The board should also establish arrangements to consider how to apply corporate reporting, risk management and internal control principles

- *corporate reporting.* The directors should include in the annual report an explanation of the basis on which the company generates revenue and makes a profit from its operations
- *appropriate remuneration principles.* The performance-related elements of executive directors' remuneration should be designed to align their interests with those of shareholders and to promote the long-term success of the company. Remuneration incentives should be compatible with the company's risk policies and systems, and the criteria for paying bonuses should be risk adjusted. Consideration should be given to the use of provisions that permit the company to reclaim variable components of remuneration arrangements in exceptional circumstances of misstatement or misconduct
- *board evaluation reviews.* The board should be externally evaluated at least every three years. Where consultants are used, they should provide a statement of whether they have any other connection with the company.

The FRC has sought comment on these, and other, possible changes to the Code, with a view to the revised Code being settled during 2010.

The FRC has also indicated that it plans to delete Schedule B of the 2008 version of the Code (*Guidance on liability of non-executive directors: care, skill and diligence*). The FRC considers that other, more comprehensive, guidance is available from other sources. The FRC has stated that, if necessary, the material in the Schedule could form part of updated guidance that the UK Institute of Chartered Secretaries and Administrators International (ICSA) has been commissioned to develop on behalf of the FRC (see Section 4.2.5).

### **4.2.3 Walker report**

The report by Sir David Walker *A review of corporate governance in UK banks and other financial industry entities: Final*

*recommendations* (November 2009) examined corporate governance in the UK banking industry and other financial institutions. The report noted that one of the effects of the recent destabilisation of global financial markets has been to highlight the importance of boards having effective procedures to manage risk. In this context, the report raised concerns about the balance in board composition of these institutions, in particular about the possible over-emphasis on directors being independent at the expense of individuals with relevant industry expertise to understand and manage risk.

The Walker report also raised other governance matters of general application to company directors. It pointed out that a critical part of good corporate governance lies in the ability and experience of individual directors and others involved in management and the effectiveness of their joint collaboration in the enterprise. The report identified what it considered were principles of best board practice, such as:

The sequence in board discussion on major issues should be: presentation by the executive, a disciplined process of challenge, decision on the policy or strategy to be adopted and then full empowerment of the executive to implement. ... The most critical need is for an environment in which effective challenge of the executive is expected and achieved in the boardroom before decisions are taken on major risk and strategic issues. For this to be achieved will require close attention to board composition to ensure the right mix of both financial industry capability and critical perspective from high-level experience in other major business. It will also require a materially increased time commitment from the NED group on the board overall for which a combination of financial industry experience and independence of mind will be much more relevant than a combination of lesser experience and formal independence. In all of this, the role of the chairman is paramount, calling for both exceptional board leadership skills and ability to get confidently and competently to grips with major strategic issues. With so substantial an expectation and obligation, the chairman's role ... will involve a priority of commitment leaving little time for other business activity.<sup>71</sup>

The discussion in the Walker Report of the role of institutional investors is discussed in Section 4.2.4.

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<sup>71</sup> at 12.

#### 4.2.4 Code for institutional shareholders

There is increasing emphasis in the United Kingdom on the importance of engagement by institutional shareholders in the governance of companies in which they invest. This has implications for the boards of those investee companies.

##### *ISC code*

The Institutional Shareholders' Committee<sup>72</sup> *Code on the responsibilities of institutional investors* (2009) (ISC Code) provides guidance on how institutional shareholders should engage with companies in which they invest, including that these shareholders should:

- monitor their investee companies, including by satisfying themselves, to the extent possible, that the investee company's board and sub-committee structures are effective, and that independent directors provide adequate oversight<sup>73</sup>
- establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value. Institutional investors may consider intervening when they have concerns about the company's strategy and performance, its governance or its approach to the risks arising from social and environmental matters<sup>74</sup>
- have a clear policy on voting and disclosure of voting activity, including seeking to vote all shares held and not automatically supporting the board, and publicly disclosing voting records.<sup>75</sup>

The ISC Code is voluntary. However, the UK Combined Code recommends that institutional shareholders apply the principles in the ISC Code.<sup>76</sup>

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<sup>72</sup> The members of the Institutional Shareholders' Committee are the Association of British Insurers, the Association of Investment Trust Companies, The National Association of Pension Funds and the Investment Management Association.

<sup>73</sup> Principle 3.

<sup>74</sup> Principle 4.

<sup>75</sup> Principle 6.

<sup>76</sup> Combined Code Section E.

### ***Proposed Stewardship Code***

The Walker report considered that there was a need for better engagement between fund managers and the boards of companies in which they invest. It recommended that the ISC Code be ratified by the FRC and become the Stewardship Code.<sup>77</sup>

The FRC document *Consultation on a Stewardship Code for Institutional Investors* (January 2010) sought comments on the proposal in the Walker Report, including whether the FRC should accept oversight of the Stewardship Code, the content of that Code (including in what respects, if any, it should go further than the ISC Code), and whether institutional investors should be encouraged to apply the Stewardship Code, if introduced, on a ‘comply or explain’ basis.

#### **4.2.5 Private sector guidance**

Much of the guidance provided by UK professional and industry bodies is built around, or is related to, matters dealt with in the Code.

The UK Institute of Chartered Secretaries and Administrators International (ICSA) has published good practice guidance and related documents on various matters relevant to directors and boards, including:

- *Induction of directors*
- *Due diligence for directors*
- *The roles of the chairman, chief executive and senior independent director under the Combined Code*
- *ICSA guidance on directors’ service contracts*
- *ICSA guidance on directors’ general duties [under the UK Companies Act 2006]*
- *ICSA guidance on protection against directors’ and officers’ liabilities—indemnities and insurance.*

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<sup>77</sup> *A review of corporate governance in UK banks and other financial industry entities: Final recommendations* (November 2009) Recommendation 17.

The ICSA document *Boardroom Behaviours* (June 2009) contains an outline of what it sees as the essential components of sound corporate governance practice at the board level, which directors and boards might choose to keep in mind as a guidance tool for their own situations, namely:

- a clear understanding by directors of the role of the board
- the appropriate deployment of knowledge, skills, experience, and judgment
- independent thinking
- the questioning of assumptions and established orthodoxy
- challenge that is constructive, confident, principled and proportionate
- rigorous debate
- a supportive decision-making environment
- a common vision, and
- the achievement of closure on individual items of board business.

The ICSA document also points out that the degree to which this outcome can be achieved is shaped by a number of key personal and interpersonal behavioural factors, including:

- the character and personality of the directors
- the dynamics of their interactions
- the balance in the relationship between the key players, especially between the chair and the CEO, the CEO and the board as a whole, and executive and non-executive directors
- the environment within which board meetings take place, and
- the culture of the boardroom and, more widely, of the company.

The FRC commissioned ICSA in 2009 to update the ICSA good practice guidance, developed from the Higgs Report, including the roles of the chair and non-executive directors.

Other bodies, including the UK Institute of Directors, provide guidance for directors through the offer of training and development courses, publications, and forums for the dissemination of information and views on matters arising from time to time relevant to directors and boards.

### 4.3 North America

Guidance to directors in the USA stems in large part from the working of the legal and regulatory framework within which companies operate. The system is backed by enforcement action in the courts by prosecutors, regulators and private litigants and decisions by courts such as the influential Delaware Court of Chancery on matters of corporate law and governance. Directors are subject to state and federal corporate laws, including the Sarbanes-Oxley Act, which introduced a range of responsibilities for public company boards on corporate governance, internal control assessment and financial disclosure.

There is less reliance on officially endorsed codes of conduct than is the case in the United Kingdom. There does not appear to be any equivalent of the UK-style *Corporate Governance Code* or the ASX Council *Corporate Governance Principles and Recommendations*.

Regulators provide guidance to directors in various forms. The US Securities and Exchange Commission (SEC), in the context of securities regulation, in addition to its rule-making power, provides administrative interpretations of relevant legislation and other forms of compliance guidance, including through published no-action letters and exemptive relief.

The SEC also publishes an *Enforcement Manual*, which provides guidance on the policies, priorities and procedures of the SEC in the investigation of potential violations of the federal securities laws. However, the Manual does not restrict the SEC in its enforcement functions as it:

is not intended to, does not, and may not be relied upon to create any rights, substantive or procedural, enforceable at law by any party in any matter civil or criminal.<sup>78</sup>

The American Law Institute (ALI), an independent organization, was established in 1923 to promote scholarly work to adapt US law to changing social needs. The ALI publishes *Restatements of the Law*, being non-binding model statutes and principles of law designed to clarify, modernise and otherwise improve US law, together with factual illustrations in the form of worked examples of how the relevant principles might operate in practice. One of its restatements, *Principles of Corporate Governance: Analysis and Recommendations*, was first produced in 1994 and is upgraded annually. It examines the duties and responsibilities of directors and officers of business corporations to their company and their shareholders. Intended both to summarise and to improve existing US corporate law (which in this area is state-based), this work combines analysis of current legal governance requirements with recommendations for clarifications or changes that it concludes are appropriate. Topics covered are:

- *the objective and conduct of the business corporation*, including a duty to act in a lawful manner and a right to take into account appropriate ethical considerations<sup>79</sup>
- *the structure of the corporation*, including the composition, functions and powers of the board, the informational and other rights of directors, and the role of the principal board committees, such as the audit committee, the board nomination committee and the compensation committee<sup>80</sup>
- *the duty of care and the business judgment rule*, including the elements of the rule, and reliance by directors on board committees and information supplied by others<sup>81</sup>

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<sup>78</sup> SEC Enforcement Manual Section 1.1.

<sup>79</sup> American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* (1994) Part II. See further the CAMAC report, *The social responsibility of corporations* (December 2006).

<sup>80</sup> Part III and Part III-A.

<sup>81</sup> Part IV.

- *the duty of fair dealing*, including disclosure and other obligations of directors where conflicts of duty and self-interest arise in matters affecting the corporation, compensation of directors, use by directors of corporate information or opportunities, and competition with the corporation<sup>82</sup>
- *the role of directors and shareholders in transactions in control and tender offers*, including the actions of directors that have the foreseeable effect of blocking takeover offers<sup>83</sup>
- *corporate remedies*, including the role of the board in actions brought by shareholders on behalf of the company.<sup>84</sup>

Each of these topics is dealt with in a separate part, containing a recommended rule or principle and a comment, which explains in detail the background, rationale, and scope of the recommended rule or principle, compares it to the present state of the law and suggests how it might best be implemented. The references to legislation and case law are updated annually, and an indication is given of their implications for the recommended rules or principles.

In Canada, the Ontario Securities Commission publishes information for companies, which includes disclosure and other requirements relevant to directors and boards.

There are also many private sector bodies offering guidance to directors and boards on issues affecting them, through research, information dissemination, consultation, peer-to-peer meetings and advisory services. These include:

- *American Bar Association Committee on Corporate Laws*, which publishes the *Corporate Director's Guidebook*, which deals with the role of directors and the functions of boards
- *the Corporate Library*, which provides independent information and analysis about US and Canadian corporate governance and executive and director compensation

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<sup>82</sup> Part V.

<sup>83</sup> Part VI.

<sup>84</sup> Part VII.

- *the National Association of Corporate Directors* (USA), which provides director education, boardroom services and governance resources
- *the Institute of Corporate Directors* (Canada), which provides professional development activities through formal director education, provision of information and resources and board placement and networking opportunities
- *the Business Roundtable*, an association of chief executive officers of leading companies, which has a corporate leadership initiative and publishes various documents promoting good corporate governance, including *Principles of Corporate Governance 2005* (which covers the role of the board of directors and how it performs its oversight function), *Guidelines for Shareholder-Director Communications* (2005) and *The Nominating Process and Corporate Governance Committees: Principles and Commentary* (2004).

#### 4.4 International standards

A number of international bodies have produced reports or recommendations on aspects of corporate governance. While largely directed to governments and regulators in member countries, these reports can also be of value to directors and boards.

##### 4.4.1 OECD

The OECD *Principles of Corporate Governance*, and various related reports, are designed to assist governments in their efforts to evaluate and improve their corporate governance frameworks and to provide guidance for financial market participants and regulators. The OECD principles and reports constitute non-binding governance standards on which national regulators, boards and directors can draw.

The OECD *Principles of Corporate Governance* cover the legal duties of the board, as well as its key functions, including in relation to corporate strategy, risk, and supervision of the company's financial and governance performance. The Principles also emphasise the role of the board in setting a company's ethical standards and the use of internal codes of conduct to maintain those standards:

The board has a key role in setting the ethical tone of a company, not only by its own actions, but also in appointing and overseeing key executives and consequently the management in general. High ethical standards are in the long term interests of the company as a means to make it credible and trustworthy, not only in day-to-day operations but also with respect to longer term commitments. To make the objectives of the board clear and operational, many companies have found it useful to develop company codes of conduct based on, inter alia, professional standards and sometimes broader codes of behaviour.

The OECD report: *Corporate Governance and the Financial Crisis: Key Findings and Main Messages* (June 2009) examined corporate governance practices in light of the instability in global financial markets in recent times. Some of the findings include:

#### ***Board practices generally***

- It appears difficult and perhaps impossible to find a ‘silver bullet’ in the form of laws and regulations to improve board performance. This leaves the private sector with an important responsibility to improve board practices through, inter alia, implementing voluntary standards.
- The objective should be to facilitate the creation of competent boards that are capable of objective and independent judgment. While there is no inherent conflict between independence and competence, it is important to keep in mind that formal independence should sometimes be a necessary, but never a sufficient, condition for board membership. A board evaluation process, conducted with the support of independent experts on a regular basis, should be used as a structural tool for monitoring board effectiveness and efficiency.
- It should be considered good practice that boards develop specific policy for the identification of the best skill composition of the board, possibly indicating the professional qualities whose presence may favour an effective board. Especially in banks, some form of continuing training is required.

#### ***Risk management***

- It should be fully understood by regulators and other standard setters that effective risk management is not about eliminating risk-taking, which is a fundamental driving force in business and

entrepreneurship. The aim is to ensure that risks are understood, managed and, when appropriate, communicated.

- It should be considered good practice to involve the board in both establishing and overseeing the risk management structure.
- The board should also review and provide guidance about the alignment of corporate strategy with risk appetite and the internal risk management structure.
- With few exceptions, risk management is typically not covered, or is insufficiently covered, by existing corporate governance standards or codes. Corporate governance standard setters should be encouraged to include or improve references to risk management in order to raise awareness and improve implementation.

### *Executive remuneration*

- The governance of remuneration/incentive systems has often failed because negotiations and decisions are not carried out at arm's length.
- In many cases it is striking how the link between performance and remuneration is very weak or difficult to establish. The use of company stock price as a single measure does not allow for the benchmarking of a company's specific performance against an industry or market average.
- Defining the structure of remuneration/incentive schemes is a key aspect of corporate governance and companies need flexibility to adjust systems to their own circumstances. Such schemes are complex and the use of legal limits such as caps should be limited to specific and temporary circumstances. The balance between the fixed and variable components of remuneration packages should be carefully considered at company level, and the regulatory framework should not induce a shift towards excessive fixed remuneration components.
- Steps must be taken to ensure that remuneration is established through an explicit governance process where the roles and responsibilities of those involved, including consultants, and risk managers, are clearly defined and separated. It should be

considered good practice to give a significant role to non-executive independent board members in the process.

- In order to increase awareness and attention, it should be considered good practice to submit remuneration policies to the annual meeting and, as appropriate, to shareholder approval.

The follow-up OECD report *Corporate Governance and the Financial Crisis: Conclusions and emerging good practices to enhance implementation of the Principles* (February 2010) sought to provide further guidance to boards on the matters contained in the OECD June 2009 report, including:

### ***Board practices generally***

- To perform better, boards need to be supported in key areas. To this end, it is important for the Chair to play a key role in ensuring that the board tackles the most important issues facing a company. The roles of CEO and Chair are increasingly being separated but where this is not the case, it is appropriate for a company to explain what measures have been taken to avoid conflicts of interest. To promote competent boards, it is good practice for board members to have access to training programs, underpinned by periodic external board evaluations. It is considered important for a board nomination committee or equivalent to specify the skills and experience required by the board and to identify appropriate individuals. As in the Principles, shareholders should also be able to nominate board members and have a significant role in their appointment. Finally, the board structure, composition and working practices need to reflect the complexity of the company and ensure clear lines of responsibility and accountability throughout the organisation.

### ***Risk management***

- An important conclusion is that the board's responsibility for defining strategy and risk appetite needs to be extended to establishing and overseeing enterprise-wide risk management systems. The report notes that in some important cases the risk management system was not compatible with a company's strategy and risk appetite. Along the lines of the Principles which recommend that internal control functions report directly to the audit committee or equivalent, the report argues that it is

good practice for the risk management function to be able to report directly to the board. The risk management function also needs to consider any risks arising directly from the compensation and incentive systems. It is important that the process of risk management and assessments of its effectiveness be appropriately disclosed. The report also notes that experience up till now with such disclosures has not been good.

### ***Executive remuneration***

- Executive remuneration has been an important public policy issue for some time. The report reinforces the position of the Principles that this is a responsibility of the board. It is important for boards first to set the strategic goals of the company and its associated risk appetite. They are then in a position to establish a compensation structure that meets a small number of performance metrics based on these goals. An explicit governance process needs to be established that will also define the role and duties of compensation consultants who are increasingly important. Good practice is for the process, remuneration structure and performance to be made transparent through some form of remuneration report. There also needs to be a possibility for shareholders to express their views about remuneration policy.

### **4.4.2 Bank for International Settlements**

The Basel Committee on Banking Supervision has reviewed board practices and risk management approaches for banks in its consultative document *Principles for enhancing corporate governance* (March 2010). The Committee points out that, in recent years, there have been several corporate governance failures and lapses for banks, including instances of insufficient board oversight of senior management and inadequate risk management. The document is intended to give banks guidance on enhancing their governance frameworks and to assist supervisors in assessing the quality of these frameworks, without this guidance constituting a new regulatory framework in addition to existing national legislation, regulation or codes. The document outlines and discusses principles for enhancing bank board performance and ensuring effective risk management and internal controls.

#### 4.4.3 The Committee of European Banking Supervisors

The Committee of European Banking Supervisors (CEBS) provides advice to the European Commission on policy and regulatory issues related to banking supervision. The analysis in its report *High level principles for risk management* (February 2010) is aimed mainly at large and complex institutions, but can be adapted to any institution taking into account its size, nature, and complexity. The report seeks to provide guidance in various areas where weaknesses have emerged during the financial crisis, such as:

- governance and risk culture
- risk appetite and risk tolerance
- the role of the chief risk officer and risk management functions
- risk models and integration of risk management areas
- new product approval policy and process.

#### 4.4.4 Financial Stability Board

The Financial Stability Board (set up by the G20 in April 2009 as the successor body to the Financial Stability Forum, which was founded in 1999 by the G7 Finance Ministers and Central Bank Governors) in its report *Principles for Sound Compensation Practices: Implementation Standards* (September 2009) discusses the appropriate role of the remuneration committee of the board as an integral part of the governance structure of significant financial institutions.

#### 4.4.5 European Confederation of Directors' Associations

The European Confederation of Directors' Associations, a private sector organization, has published *Corporate Governance Guidance and Principles for Unlisted Companies in Europe* (March 2010), as a means of promoting the growth and sustainability of these companies in Europe. The report:

provides guidance for unlisted companies on the issues involved in designing an appropriate corporate governance framework. It also presents a set of governance principles that can be followed or not. This remains a voluntary decision of each unlisted company.

The report puts forward corporate governance principles applicable to all unlisted companies:

- shareholders should establish an appropriate constitutional and governance framework for the company
- every company should strive to establish an effective board, which is collectively responsible for the long-term success of the company, including the definition of the corporate strategy. An interim step on the road to an effective (and independent) board may be the creation of an advisory board
- the size and composition of the board should reflect the scale and complexity of the company's activities
- the board should meet sufficiently regularly to discharge its duties, and be supplied in a timely manner with appropriate information
- levels of remuneration should be sufficient to attract, retain, and motivate executives and non-executives of the quality required to run the company successfully
- the board is responsible for risk oversight and should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets
- there should be a dialogue between the board and the shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place. The board should not forget that all shareholders have to be treated equally
- all directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge
- family-controlled companies should establish family governance mechanisms that promote coordination and mutual understanding amongst family members, as well as organize the relationship between family governance and corporate governance.

The report puts forward additional corporate governance principles applicable to large and/or more complex unlisted companies:

- there should be a clear division of responsibilities at the head of the company between the running of the board and the running of the company's business. No one individual should have unfettered powers of decision
- board structures vary according to national regulatory requirements and business norms. However, all boards should contain directors with a sufficient mix of competencies and experiences. No single person (or small group of individuals) should dominate the board's decision-making
- the board should establish appropriate board committees in order to allow a more effective discharge of its duties
- the board should undertake a periodic appraisal of its own performance and that of each individual director
- the board should present a balanced and understandable assessment of the company's position and prospects for external stakeholders, and establish a suitable program of stakeholder engagement.

#### **4.4.6 Other organizations**

The International Corporate Governance Network sponsors conferences and provides a range of publications, including discussion papers, best practice guidance and newsletters, on corporate governance issues.

The World Council for Corporate Governance sponsors conferences and publishes information on best practices in governance, including for company boards.

The European Corporate Governance Institute provides an information base on developments world-wide, as well as being a forum for debate and dialogue between academics, legislators and practitioners on governance issues and ways to promote best practice for companies and their boards. A comparable discussion role is undertaken by the Commonwealth Association for Corporate Governance and the Asian Corporate Governance Association.

The Global Director Development Circle was founded in 2004 in response to the increasingly international nature of business and the need for directors to keep abreast of developments in governance

and legislation across multiple markets. It is made up of professional membership organizations for directors from various countries, including the AICD in Australia, and aims to share expertise in corporate governance and professional director development.

## 5 Advisory Committee response

*This chapter sets out the Advisory Committee's views in response to the questions in the terms of reference. While there is already a good deal of guidance available to directors, there is scope for continuous improvement having regard to the experience of companies and boards in Australia and elsewhere. The provision of guidance in itself will not ensure improved governance, but efforts to assist directors to understand their role and enhance their effectiveness are worthwhile and should be pursued. The Committee does not see a need for the development of a new code of conduct or best practice guidance by a regulator. It would, however, be timely for the ASX Corporate Governance Council to review its principles and recommendations in light of international developments. The Committee also encourages the continuing efforts by regulators and by relevant bodies and participants in the private sector to develop guidance in relevant areas. There is scope for leadership in the refinement of approaches to corporate governance, including in the softer areas that go to how directors actually carry out their role and work effectively in a board context.*

### 5.1 Matters for consideration

The Committee has been asked to consider the adequacy of guidance available to directors in Australia, having regard to the position in other countries, and whether the performance of directors in Australia might be enhanced through an additional form of guidance such as a code of conduct introduced by a relevant regulator.

### 5.2 Preliminary comments

By way of preliminary comment, the Committee draws attention to the benefits and the limitations of any form of guidance.

The overriding responsibility of directors is to act in the best interests of the company. This can be a difficult and demanding task. It includes, but goes beyond, an understanding of compliance and other legal issues. First and foremost, it requires directors to focus on the business of the company and direct it towards success.

Depending on the circumstances, directors may find assistance in carrying out their roles from the experience of others, including recommended standards of best practice. While the needs of directors and boards may vary, improved guidance, or better use of available guidance, may enhance the performance of directors and boards.

It should be recognised that guidance has its limits. No amount of guidance, in whatever form, can prepare directors for all the eventualities they may have to face.

Equally, guidance on corporate governance cannot eliminate risk or guarantee corporate success. As pointed out in the OECD report *Corporate Governance and the Financial Crisis: Key Findings and Main Messages* (June 2009):

effective risk management is not about eliminating risk-taking.

Rather, it is about identifying and managing risk in the best interests of the company.

Again, guidance on matters of governance will not necessarily ensure better performance by individual directors any more than guidance or advice in other areas of human behaviour ensures good conduct. Some individuals most in need of guidance may decline to seek it, choose to ignore it or not be capable of applying it.

While guidance cannot guarantee that failures do not occur, it can provide directors with information and tools that will contribute to a more effective board process and better equip them to deal with issues that arise.

There is research indicating that, in general, companies that follow good governance practices may be expected to perform better,<sup>85</sup> though the nature of any correlation between particular governance practices and overall corporate performance is not easy to determine.<sup>86</sup> At a minimum, some investors may be deterred from investing in companies that rank poorly on corporate governance measures.<sup>87</sup>

Nevertheless, directors and boards who take their role seriously are likely to have regard to, and test their own thinking and experience against, the accumulated wisdom of others in the field and

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<sup>85</sup> For instance, Goldman Sachs JB Were *Corporate Governance Investing Update* (16 March 2010), A Renders, A Gaeremynck & P Sercu, 'Corporate Governance Ratings and Company Performance: A Cross-European Study' (2010) 18 *Corporate Governance: An International Review* 87, R Brown & T Gørgens, *Corporate governance and financial performance in an Australian context* (Treasury Working Paper 2009 — 02, March 2009) and the studies therein cited, Hermes, *Corporate Governance and Performance: A brief review and assessment of the evidence for a link between corporate governance and performance* (2005) and the studies therein cited.

Treasury Working Paper 2009 — 02, a study of the top 300 Australian listed companies, concludes that:

- companies demonstrating greater compliance with the ASX Corporate Governance Principles outperform less compliant companies in the areas of shareholder performance, operating performance and one-year sales growth
- most of the relevant literature on overseas jurisdictions suggests that companies with better corporate governance structures outperform companies with poorer corporate governance in a number of performance areas.

<sup>86</sup> Some studies have pointed out that an established relationship between good governance and performance does not mean that the good governance practices are the cause of the enhanced performance: R Brown & T Gørgens, *Corporate governance and financial performance in an Australian context* (Treasury Working Paper 2009 — 02, March 2009), Hermes, *Corporate Governance and Performance: A brief review and assessment of the evidence for a link between corporate governance and performance* (2005).

The Treasury Working Paper noted (at 3):

while it is possible that companies that choose to comply with the ASX Corporate Governance Principles will perform better because of it, it is also possible that companies that perform better are more likely to choose to comply as it is easier for them to do so when things are going well.

The Hermes paper said that:

- some good governance practices may be more instrumental in effecting good corporate performance than others
- active participation by shareholders and oversight of management concerning governance standards may be the important factors in performance, rather than the governance standards themselves.

<sup>87</sup> For instance, the RiskMetrics *Governance Risk Indicators* (GRId), released in March 2010, are intended to allow investors to sift out companies that perform poorly on corporate governance indicators concerning audit outcome, board process, compensation and shareholder rights.

recommended good governance courses of action. While other directors may be slower to do so, leadership and the example of those who are successful, together with the expectations of investors and others, can lead to improved standards of corporate governance over a period. In the Committee's view, efforts to assist directors to understand their role and enhance their effectiveness are worthwhile and should be encouraged and pursued.

### 5.3 International guidance

Experience in the United Kingdom and North America, as well as international guidance standards, as reviewed in Chapter 4, are a useful source for the identification of trends and ideas for the development of guidance for directors in Australia.

Guidance to directors in the United Kingdom is currently under close review, including:

- the work currently being undertaken by the Financial Reporting Council on possible changes to the Combined Code on Corporate Governance as it relates to the role and functions of individual directors and boards of listed entities, including behavioural guidance in regard to effective director participation on boards
- the conclusions of the UK Walker report (on which the Financial Reporting Council is drawing as part of its review of the Code), including on the balance in board composition between independence and expertise and on best board practice
- the proposed UK Stewardship Code dealing with the relationship between boards of listed entities and institutional investors.

There has been considerable development of international guidance standards, including reviews by the OECD and other international organizations of corporate governance practices in light of recent instability in global financial markets, as well as further thinking on ways to promote better board practice.

Some of the matters that have been proposed or considered include:

- *the balance between independence and industry expertise in board composition.* As the OECD report *Corporate Governance and the Financial Crisis: Key Findings and Main Messages* (June 2009) has pointed out:

While there is no inherent conflict between independence and competence, it is important to keep in mind that formal independence should sometimes be a necessary, but never a sufficient, condition for board membership.<sup>88</sup>

- *participation by non-executive directors in board deliberations.* As observed in the UK Code:

As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy. Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible.<sup>89</sup>

- *regular performance reviews of the chair, individual directors and the board itself*
- *the frequency of elections, including consideration of annual election for directors or the chair at least*
- *interaction with shareholders.* The FRC paper *Consultation on a Stewardship Code for Institutional Investors* (January 2010) includes a proposal for a new Stewardship Code to provide guidance on how institutional shareholders should engage with companies in which they invest
- *enhancement of current guidance on risk management in light of experience in the financial services sector.*

The Committee notes these matters as emerging issues that may call for further consideration in Australia. It has not consulted interested parties or reached any conclusion on particular aspects.

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<sup>88</sup> at 10.

<sup>89</sup> Section A.1 Supporting Principles.

The Committee notes that guidance initiatives in the USA, in particular the American Law Institute (ALI) *Principles of Corporate Governance: Analysis and Recommendations*, are also a valuable source of guidance for directors. To the extent that those recommendations are based on particular legal principles, care needs to be taken, of course, in applying them in Australia. As observed by Austin J in *ASIC v Rich* [2009] NSWSC 1229 at [7257] in relation to the ALI business judgment rule:

While the ALI's formulation of the US [business judgment] rule, and the wealth of US case law on the subject, provide a useful resource when a business judgment rule is raised in Australian litigation, obviously the primary task of an Australian court is to construe and apply the statute, which is not necessarily a complete reflection of the US position.

#### 5.4 Adequacy of guidance in Australia

As discussed in Chapter 3, there is already a good deal of guidance available in Australia to help directors, both executive and non-executive, to understand their duties and responsibilities. The Committee does not see a general lack of information and guidelines in relation to those duties and responsibilities. At the same time, there is a continuing challenge in articulating and promulgating information and guidance in ways that will engage directors and assist them.

Much of this guidance focuses on the duties and responsibilities of directors, as well as compliance and governance issues for boards. While these matters are difficult to gauge, the Committee does not see any indication that directors as a whole lack an understanding of their duties and responsibilities nor of a general failure in corporate governance by Australian companies.

There is growing recognition of the benefits of guidance on broader behavioural issues that go to the effectiveness of a director and the effective functioning of a board. There is room for further attention to this area, with the aim of empowering directors to carry out the role expected of them and not to fall into a role of passive participant.

As indicated earlier, the provision of guidance in itself will not ensure improved governance, but efforts to assist directors to understand their role and enhance their effectiveness are worthwhile.

### 5.4.1 No need for a new code

Guidance for directors remains in a state of evolution and will continue to develop. The Committee does not consider that the performance of directors would be enhanced by the introduction by a regulator of further guidance in the form of a new code of conduct or best practice guidance. Regulators have a valuable role to play in some aspects of guidance, but may not be the best or most appropriate source of general guidance on how directors should go about their role.

As discussed earlier, there is an important line between prescription—the laying down of standards that must be followed—and guidance—the offering of approaches and forms of behaviour to help directors in carrying out their role. As pointed out in the OECD report *Corporate Governance and the Financial Crisis: Key Findings and Main Messages* (June 2009):

It appears difficult and perhaps impossible to find a ‘silver bullet’ in the form of laws and regulations to improve board performance.<sup>90</sup>

Also:

It is simply not possible to regulate for board competence and objectivity.<sup>91</sup>

Likewise, as pointed out in the HIH Royal Commission report *The failure of HIH Insurance* (2003):

... the key to good corporate governance lies in substance, not form. It is about the way the directors of a company create and develop a model to fit the circumstances of that company and then test it periodically for its practical effectiveness. It is about the directors taking control of a regime they have established and for which they are responsible. These concepts do not lend themselves easily to specification in something such as a code of best practice.<sup>92</sup>

The Committee notes also that directors, unlike members of some professional groups, are not subject to licensing or other

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<sup>90</sup> at 9.

<sup>91</sup> at 46.

<sup>92</sup> at 133.

requirements that could be employed to administer or enforce a mandatory code or best practice principles. The Committee would not see a move towards the licensing of directors as called for or useful. APRA does apply governance requirements for boards and a ‘fit and proper’ prerequisite for directors and other responsible persons in the limited context of banks and other regulated financial institutions. It would not be practical or appropriate to apply such a regulatory approach to directors generally.

There are dangers too in moving to a more prescriptive approach that attempts to codify the large volume of existing regulation. It could result in inflexibility or complexity or a focus on formal compliance rather than helping to bring about substantive improvements in governance practices and behaviour. It could also have the effect of imposing new or enhanced obligatory standards on directors in complying with their current statutory and common law duties and responsibilities. Furthermore, it may give the misleading impression that particular matters are more settled, or less open to further development, than may in fact be the case.

#### **5.4.2 ASX Corporate Governance Council**

We already have in the ASX Corporate Governance Council standards a high-level framework for the promulgation of corporate governance approaches. The Council includes representatives of a range of industry and professional bodies, convened under the auspices of the ASX. While directed at listed companies, the Council’s *Principles and Recommendations* provide a vehicle for the development and promulgation of an Australian model of recommended best practice in corporate governance to which other directors and companies could look. The *Principles and Recommendations* could be developed as an exemplar of best practice in corporate governance from an Australian perspective.

The ASX Council has undertaken a number of revisions of the Principles and Recommendations since they were first introduced.<sup>93</sup>

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<sup>93</sup> There have been two editions and further changes have been mooted: see ASX Media Release *Proposed changes to Corporate Governance Principles and Recommendations* (22 April 2010).

The Committee considers that it would be timely for the Council further to review the guidance given to directors in its *Principles and Recommendations*, given recent developments in global financial markets and further thinking in corporate governance, including in response to those developments. These include:

- *UK Code approach to guidance for directors.* The UK Code (and its proposed amendments) in various respects provides more indicative and detailed guidance for directors, and on a greater range of subject matter, than the ASX Council *Principles and Recommendations* (compare the approaches reviewed in Sections 3.5 and 4.2.2)
- *balance on boards between independence and expertise.* Various overseas studies, including the UK Walker report, have reopened the question of the appropriate balance in board composition between independence and industry expertise (see Section 4.2.3)
- *board practices generally.* The OECD report *Corporate Governance and the Financial Crisis: Key Findings and Main Messages* (June 2009) and the follow-up February 2010 report, as well as the Basel Committee on Banking Supervision consultative document *Principles for enhancing corporate governance* (March 2010), make a range of suggestions concerning good corporate governance for boards generally (see Section 4.4)
- *risk management.* There have been several developments in international guidance standards on risk management, including the OECD report *Corporate Governance and the Financial Crisis: Key Findings and Main Messages* (June 2009) and the follow-up February 2010 report, as well as in the Committee of European Banking Supervisors report *High level principles for risk management* (February 2010) (see Section 4.4)
- *executive remuneration.* The Productivity Commission report *Executive Remuneration in Australia* (December 2009) has put forward some best practice guidance in relation to accountability and disclosure concerning executive remuneration (see Section 3.6.2). Good practice guidance ideas have also been put forward in the earlier OECD report *Corporate Governance and the Financial Crisis: Key Findings and Main Messages* (June 2009) and the follow-up February 2010 report, as well as

in the Financial Stability Board report *Principles for Sound Compensation Practices: Implementation Standards* (September 2009) (see Section 4.4). These matters can be considered in the context of forthcoming legislative amendments, and the foreshadowed review by CAMAC<sup>94</sup>

- *shareholder engagement*. There has been a series of initiatives in the United Kingdom regarding the role of institutional investors, including a proposal in the Walker Report to introduce a Stewardship Code (see Section 4.2.4).

The Committee has drawn attention to some of these developments in Section 5.3.

Care needs to be taken in matters of governance practice and behaviour not to be inadvertently prescriptive. The current ‘if not, why not’ approach aims to allow some flexibility in the application of the ASX Corporate Governance Council *Principles and Recommendations* to particular companies. The challenge is to be sufficiently indicative and forthright to provide direction, without creating a straightjacket or a system that lends itself to the ticking of boxes or emphasis on form over substance. Within the existing ASX framework, there is room for continuing development, including drawing on initiatives elsewhere.

### 5.4.3 Regulators

Regulators, particularly ASIC and APRA, have an important role in providing guidance to directors in areas of compliance relevant to their mandate.<sup>95</sup>

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<sup>94</sup> Joint Treasury Media Release No. 033 of 16 April 2010 *Government responds to the Productivity Commission report on executive remuneration*.

<sup>95</sup> Some principles on regulatory guidance that have been developed in the United Kingdom are set out in the UK Department for Business, Innovation and Skills (BIS) paper *Code of practice on guidance on regulation* (October 2009). The principles take the form of ‘eight golden rules of good guidance’, namely, that guidance by regulators should be:

- based on a good understanding of users
- designed with input from users and their representative bodies
- organized around the user’s way of working
- easy for the intended users to understand
- designed to provide users with confidence in how to comply with the law
- issued in good time

The Committee encourages ASIC to continue to develop its regulatory guidance, with a mind to assisting directors to understand the approach it will take in particular areas. This can include how it will interpret and apply the law in various contexts, its expectations concerning what is appropriate conduct for directors and others in particular circumstances and when and how it will exercise specific powers.

It is noted that some regulators, such as the SEC in the USA, publish enforcement manuals that address the way that they will enforce the law in critical areas. While a regulator needs to be careful not to unduly restrict its ability to enforce the law, this is an area where ASIC, by further articulating its compliance and enforcement policies and priorities (possibly in an enforcement manual), may be able to provide useful assistance to directors.

#### 5.4.4 Private sector

There is already a good deal of useful activity in the private sector, drawing on the experience of directors and boards to provide guidance in one form or other. Participants in the corporate area have the opportunity to encourage and develop higher standards of performance by directors and boards. There is scope for professional and industry associations and others to show leadership in this regard. This can be offered through further formal or informal leadership or mentoring programs, as well as through the use of 'frequently asked questions' (FAQ) and structured reviews, as well as in other ways. The Committee encourages the further development of guidance programs, services and other initiatives.

There is room for further work on behavioural factors that help promote board effectiveness. Qualitative research on the skills and behaviour needed for an individual to work effectively as a director was conducted in the UK by private sector bodies as part of the Higgs review. There may be scope for further work to be undertaken, or sponsored, by professional or industry bodies, research organizations or academic institutions. Similarly, private

- 
- easy to access
  - reviewed and improved.

See also the BIS follow-up document: *Progress report on commitments made in response to the Anderson Review* (March 2010).

sector bodies can help identify emerging needs through periodic qualitative surveys and ongoing discussions with directors, including the matters on which directors might most usefully be given more guidance.

The Committee also sees scope for further work on guidance for directors of unlisted companies, not-for-profit entities and public sector bodies. The recent report by the European Confederation of Directors' Associations, *Corporate Governance Guidance and Principles for Unlisted Companies in Europe* (March 2010) (see Section 4.4.5), is an example of work in this area.

## Appendix 1 Letter from the Minister

12 August 2009

Mr Richard St John  
Convenor  
Corporations and Markets Advisory Committee  
GPO Box 3967  
SYDNEY NSW 2001

Dear Mr St John

I am writing to refer an aspect of Australia's corporate governance framework to the Corporations and Markets Advisory Committee for its consideration and advice.

While Australia has a world-class corporate governance framework, the importance of continuing to assess it against international best practice has been highlighted by the recent global economic crisis. An integral part of corporate governance best practice is that boards of publicly listed companies have executive directors, who are full-time employees of the company, concerned primarily with the daily management of company business, and a majority of non-executive directors (NEDs) who are independent of management. NEDs provide a corporate board with particular skills, experience and independence, performing an important function in Australia's corporate governance framework. In asking the Committee to examine what guidance is required for both executive directors and NEDs to fully understand the responsibilities of their role, I am particularly interested in what support can be provided to increase the engagement of NEDs with their position on the board and bring an independent and broad view to board decision making.

In 1992 the *Report of the Committee on the Financial Aspects of Corporate Governance* (the Cadbury Report) called for a code of best practice to enhance the standards of corporate behaviour in the UK. The report sparked interest across the globe and, following the

subsequent Rutteman Report (*Internal Control and Financial Reporting*), the Greenbury Report (*Study Group on Directors' Remuneration*), and the Hampel Report (*Committee on Corporate Governance*), led to the introduction of the Code of Best Practice in the UK and similar codes in a number of other countries. In 2002 the ASX convened the Corporate Governance Council to produce corporate governance guidelines for listed entities. In 2003 the Council released the first edition of its *Principles of Good Corporate Governance Practice and Best Practice Recommendations* (ASX Principles). The overall intention of the guidelines was to help investors make more informed decisions about the company's corporate governance practices. To this end the guidelines, and the subsequent second edition developed in 2007, have been extremely effective.

Absent from the ASX Principles, however, is any guidance or recommendations for NEDs about what is expected of individuals in that position. The responsibility for clarifying the role of executive directors and NEDs was instead placed on the company itself (Recommendation 3.1). When the ASX Principles were reviewed in 2007, the issue of providing further guidance to directors about their responsibilities (as separate from the overall workings of the board) was once again overlooked in the consultation.

In the UK in 2003, the *Review of the role and effectiveness of non-executive directors* (the Higgs Review) investigated the role of NEDs and made suggestions for the revision of the *Combined Code of Corporate Governance*, the predecessor to the Code of Best Practice, to include further guidance for NEDs (and directors more broadly). In response to a perceived lack of clarity about the role of NEDs expressed in the submissions to the review, the Higgs Review perceived that clarifying the core elements of the NED role would assist NEDs to fulfil their roles more effectively. The Higgs Review therefore recommended that a description of the role of the NED be incorporated into the Code.

A number of the recommendations of the Higgs Review were adopted by the UK Financial Reporting Council into its *Combined Code of Corporate Governance* as well as separately in the voluntary guidance, *Good Practice Suggestions from the Higgs Report*. As a result the Combined Code now provides a basic level of guidance to NEDs about their responsibilities on the board.

In Australia there is no comparable guidance for NEDs regarding the role that they are expected to play on a board. While industry representative organisations, for example the Australian Institute of Company Directors and the Investment and Financial Services Association, do provide some guidance to directors on their responsibilities, it is unclear whether this level of guidance is leaving current, and potential, NEDs confident in the expectations and responsibilities that are placed on a NED role. In light of the increasing expectations placed on NEDs today as a result of decisions in cases such as *Australian Securities and Investments Commission v Macdonald No.11*, all NEDs, not only those of Australia's publicly listed companies, may benefit from clarification around the expectations of the NED role.

I request that the Committee:

- examine the guidance or codes of conduct that are available overseas for corporate directors;
- examine whether there is sufficient guidance provided to executive directors and non-executive directors in Australia to ensure that they have a clear understanding of their roles and responsibilities; and
- advise whether the performance of directors would be enhanced by the introduction of guidance for directors, for example through a code of conduct or best practice guidance, by a relevant regulator; and if so what form that guidance should take.

I look forward to receiving your report by 30 April 2010.

Yours sincerely

CHRIS BOWEN



## Appendix 2 AICD activities

### Publications

The Australian Institute of Company Directors (AICD) publishes, or makes available, a range of books relevant to directors and boards of commercial and not-for-profit entities. They include the following:

#### Directors generally

- *Duties and responsibilities of directors and officers* (R Baxt). This provides information on the duties, responsibilities and personal liability of directors and officers under the Corporations Act and the common law. This is provided free to all AICD members.
- *Powerful questions* (C Norden-Powers). It considers particular interpersonal and other skills necessary for directors and others to manage companies.
- *AICD company director manual*. This brings together various facets of the legal and regulatory aspects of the role and the rights and obligations of directors.
- *Essential director* (B Tricker). This deals with corporate governance issues for directors.
- *How to identify and to manage conflicts of interest* (J Walton and K Henderson). This is designed to assist directors in considering and responding to conflicts.
- *Financial statements demystified* (D Hey-Cunningham). This aims to assist directors and others to understand a company's financial statements on such matters as financial performance, financial position and cash flows.
- *Going concern; a guide for companies and directors* (AICD & AUASB). This publication explains the concept of 'going concern' and aims to assist company directors in performing, and reporting on, their going concern assessment.

- *How to review a company's financial reports* (AICD). This is a guide for interpreting and understanding financial reports.

### Boards generally

- *How to design and implement a board induction program* (A De Lacy and G De Lacy). This discusses board induction processes for new directors
- *Inside the boardroom* (R Le Blanc). This book considers the inner workings of boards, including boardroom processes.
- *Boards that work* (G Kiel and Nicholson). It discusses the changing nature of corporate governance and the implications for the board.
- *Corporate risk management* (D Chew). It discusses the management of corporate risk, including at the board level.
- *Managing business risk* (J Reuvid). It discusses the management of corporate risk, including at the board level.
- *Executive remuneration guidelines for listed company boards* (AICD). The book notes that a core part of a board's activities involves appointing, and managing the performance of, an appropriate chief executive officer and overseeing the appointment of other senior executives.
- *Privacy and boards—what you don't know can hurt you* (Office of the Federal Privacy Commissioner & AICD). It discusses the implications for boards of privacy issues concerning companies.
- *Bullying: from backyard to boardroom* (P McCarthy, J Rylance, R Bennett & H Zimmerman). This includes a discussion of policies, management strategies and legal remedies.

### Chair of the board

- *Chairman of the Board—a role in the spotlight* (AICD). It examines the functions of the chair and issues that are shaping the way in which the role of the chair is evolving.

- *Chairman of the board* (B Lechem). It considers a range of issues for the chair, including performance evaluation of the board.
- *Leading the Board* (A & N Kakabadse). It discusses the skills and qualities for an effective chair.
- *Running board meetings* (P Dunn). This provides advice on various aspects of board meetings.

### Board committees

- *How to review and assess the value of board subcommittees* (G De Lacy). This discusses the corporate governance role and processes of board subcommittees.
- *Audit committees: a guide to good practice* (AICD/AUASB/IIA Australia). It discusses the role and responsibilities of an audit committee and the context in which it operates, including the interaction between the audit committee and internal and external auditors.
- *Remuneration committees: Good practice guide* (AICD). It discusses issues concerning the remuneration of executive and non-executive directors as well as senior executives.

### Board evaluation

- *How to implement a board performance management system* (A De Lacy and G De Lacy). This discusses performance review processes for chairmen, directors and boards, including for small and medium enterprises.
- *Evaluating board performance* (AICD). It discusses how the chair and directors can design and implement a board evaluation approach and report on outcomes to shareholders and other interested parties.
- *Board, Director and CEO Evaluation* (G Kiel, G Nicholson, M Barclay). It discusses the benefits and processes of evaluation.

## Shareholder meetings

- *Annual general meetings: a guide for directors* (AICD). This guides directors on the procedural requirements to convene and conduct annual general meetings of shareholders.
- *Joske's law and procedures at meetings in Australia* (E Magner). It includes a discussion of relevant law and practice concerning the convening and running of shareholder meetings.

## Not-for-profit entities

- *The not-for-profit director* (G De Lacy). This is designed to provide the information necessary for directors to understand their roles and the issues in the not-for-profit sector.
- *The governance of public and non-profit organizations: what do boards do* (C Cornforth). This considers the performance of not-for-profit boards.
- *The Perfect Board* (C Clemens). This discusses how to be an effective member of a board, including boards of not-for-profit organizations.
- *The book of the board* (D Fishel). It provides guidance for board or committee members of non-profit organizations.
- *Transformational boards* (B Tweeten). It deals with the functioning of non-profit boards.
- *The non-profit leadership team* (F Howe). It considers the role of the chair, board members and other managerial personnel of non-profit organizations.

## Courses

AICD conducts various courses for new or current directors, including:

- *Foundations of directorship*. This orientation course for new directors deals with governance, finance, and corporate strategy and risk.

- *Company directors course.* Matters covered include duties, responsibilities and liabilities of directors and boardroom issues.
- *International company directors course.* This covers regulatory frameworks and governance issues across jurisdictions.
- *In focus.* This covers a range of topics arising at board and board committee level, including leadership in the boardroom, the chairman, the strategic board, capital raising, the board's role in mergers and acquisitions, the board and the CEO, the board and the company secretary, reporting to the board and evaluating the board.
- *Mastering the boardroom.* This is a residential interactive course for the practising director.
- *In-boardroom.* This involves a boardroom development program.
- *The listed company director.* This is a one-day course, developed by AICD and ASX for directors of listed entities.
- *E-learning for directors.* This involves online courses providing practical advice and information on a range of topics relevant to directors, including the role of the board, the role of the director, board meetings, interpreting company financial statements and reporting to the board.
- *The not-for-profit board.* This deals with specific issues for the director or council committee member in a not-for-profit environment, including how to assess financial statements and organizational performance.

## Peer guidance and mentoring

The AICD has a series of peer guidance and mentoring programs, including:

### Director Advisory Service

A panel of senior and experienced directors provide guidance and practical counsel to other directors on matters of directorial practice, governance and board behaviour.

### **Director Nexus**

This involves group learning by directors sharing experiences and providing support and advice.

### **Fellows Forums**

This involves an opportunity for directors to discuss issues affecting directors and boards with more experienced directors.

### **ASX Roundtable Series**

This provides an opportunity for AICD members who are directors of ASX200 companies to discuss, with their peers, the latest thinking and issues arising for Australian directors.

### **Member focus groups/CD Viewpoint**

These peer groups meet to discuss current issues and other topics affecting directors.

### **Mentoring programs**

The AICD's mentoring programs include:

- *Coach and Mentor Connect*
- *ASX200 Diversity Mentoring Program*
- *Non-ASX200 Mentoring Programs.*

### **Other services**

#### **Online Information Guide**

This AICD member-only resource has been developed to provide information on selected issues concerning directors, such as:

- board performance
- D&O insurance
- director liability
- director share trading

- financial reporting
- insolvency
- OH&S matters
- remuneration
- shareholder engagement
- not-for-profit boards
- succession planning.

### **Frequently Asked Questions**

This AICD member-only resource provides general overviews and background information on the topics about which members most commonly enquire. The documents are updated to reflect changes to law and practice, with members having the opportunity to provide feedback on the content and to suggest new topics. Current topics covered include:

- roles, duties and responsibilities
- selection, appointment and remuneration
- performance and appraisal
- managing relationships
- legal aspects
- reporting requirements
- procedures for meetings.

### **Emerging Director Program**

This aims to connect not-for-profit organizations with directors who are willing to assist these entities to improve the effectiveness of their boards and the performance of their enterprises.

## Podcasts

These are designed to keep directors up to date through selected recordings of events, interviews and conference sessions.

## Board Evaluation Connect

This provides boards with access to the board evaluation market, to assess and strengthen the skills, experience and dynamics of boards, committees and individual directors.

## Events

The AICD holds a series of events throughout Australia, designed to inform and educate directors of all levels and experience.

These events include:

- *Company Director Conference (annual)*. This is designed to examine current trends in the economic and business environment, and to review director and boardroom issues through peer discussion forums, including ‘tales from the corporate battlefield’ and ‘boardroom hypothetical’ sessions
- *Public Sector Conference*. This conference focuses on the structures, processes, cultures and systems required for the successful governance of public sector organizations
- *Directing Tomorrow Today: Essential Directors’ Update*. This event covers current issues affecting directors’ responsibilities
- *Directors Briefings*. These briefings are designed to update directors with information on a wide range of topics related to all aspects of directorship.

## Appendix 3 CSA activities

### Publications

Chartered Secretaries Australia (CSA) publishes *Officers, Directors and Governance*, which outlines the roles and duties of officers and directors as defined by statute and interpreted by case law, and seeks to assist directors to understand the applicability of those duties to their organization. A new edition, to be published in 2010, will be re-titled *The Duties of Officers and Directors*.

Other titles published by CSA to assist directors and boards to understand their roles and responsibilities and which also put forward ideas for sound practice include:

- *Protecting Company Officers*
- *Enhancing Board Performance*
- *Continuous Disclosure: Listed Public Companies and other Disclosing Entities*
- *Guide to Procedures at AGMs*
- *Effective AGMs*
- *Better Communication Between Entities and Proxy Advisory Services*
- *Managing Conflicts of Interest in the Not-for-Profit Sector*
- *Enterprise Risk Management*
- *Corporate Governance and the Company Secretary*
- *Effective Corporate Communication.*

### Good Governance Guides

CSA also publishes a number of Good Governance Guides, which are available on the public domain section of its website, free of

charge. They reflect the structure of the ASX Corporate Governance Council's *Principles and Guidelines*, and provide information on the following topics:

### **Management and oversight**

- Board deliberations in relation to adopting financial reports
- Statement of matters reserved for the board
- Letters of appointment for directors: suggested contents
- Recording minutes of directors' meetings
- Board reports

### **Board structure**

- Audit committees
- Who should sit on board committees
- What a board committee charter should address
- Board committees: reporting to the board
- Auditor independence
- Appointment of alternate directors
- Board composition
- Director and ex-director access to company information
- Conflict of interest and related party transactions
- Nomination committee
- Procedure for the selection of directors
- Procedure for the nomination of directors to fill casual vacancies or as a result of a review of board skills
- Procedure for seeking professional advice

- Board decisions: when to resolve, ratify/confirm and note
- Board minutes: what to record, the business judgment rule
- Director induction packs: content
- Roles, duties and responsibilities of company secretary
- Options for board evaluation

### **Ethics and responsible decision-making**

- Trading in company securities
- Issues to consider in developing or reviewing the policy on trading in company securities
- Corporate code of conduct

### **Financial reporting**

- Signing of the annual directors' report/accounts
- Auditor relationships
- Scope of audit
- Audit Committee charter: external audit issues
- Audit Committee deliberations for adopting financial reports
- Use of auditor for non-audit work: policy statement and what it should cover

### **Disclosure**

- Communication with analysts and shareholders
- Disclosure policies and procedures
- Disclosure policies and committees
- Electronic communication with shareholders

### **Rights of shareholders**

- AGM: conduct of elections at an AGM when nominations exceed vacancies
- AGM: guidelines for directors speaking at an AGM when up for re-election
- AGMs: consideration of accounts by members
- AGMs: explaining items of special business
- Policy to promote effective communication with shareholders (other than at AGMs)
- Policy to promote effective communication at general meetings (including question time at the AGM)
- Electronic communication policy
- Policy for timing and location of general meetings

### **Risk management**

- Risk management overview
- Compliance

### **Remuneration**

- Director remuneration — NED shares

CSA also publishes a number of Good Governance Guides for not-for-profit entities on the following topics:

- Board structure
- Separation of authority between board (council) and management
- Stewardship and social responsibility
- Volunteer management
- Conflicts of interest

- Risk management policy

### Courses

CSA offers a *Graduate Diploma in Applied Corporate Governance*, which focuses on governance and risk management, as well as *Certificate in Governance Practice* and *Certificate in Risk Management* courses.

CSA also conducts an annual governance masterclass and various other education and training programs including in the areas of:

- duties of officers and directors
- assessing board performance
- financial analysis for officers and directors
- risk assessment for officers and directors
- OH&S due diligence for officers and directors.