

3.3 Board of Directors

The decision to establish a formal Board is the most significant step in the development of the Corporate Governance framework. Notwithstanding this greater degree of formality, Directors are nevertheless required under the law to meet and take decisions on behalf of the company.

A company usually decides to establish a formal Board for the following reasons:

- Provide a **greater degree of formality** and rigour to the running of the company
- Access **independent and objective** external advice
- **Utilise the experience and knowledge of Non Executive Directors.** For example, if a company needs to raise capital to fund expansion, it would be helpful to have somebody on the Board with this experience
- **Assist the growth of the company** and bring on board Non Executive Directors with experience of joint ventures, key markets, etc.
- Raise the **profile and stature** of the company

Establishing a more formal Board requires careful consideration, since it can be difficult to reverse the decision. The latter may have an adverse impact on the company and the reputations of those concerned, if not handled appropriately.

The implications of having a formal Board need to be considered. For example, the appointment of a Board means there will be a greater degree of formality in place in the company and this may result in greater attention to detail and a longer decision-making process.

There are many companies that are very successful, but yet do not have a formal Board. In general, however, the appointment of a Board, with the appropriate skills and expertise, will be of enormous benefit to an ambitious company.

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Role of the Board of Directors

- Provide entrepreneurial leadership of the company, within a framework of prudent and effective controls which enables risk to be assessed and managed (Combined Code, July 2003)
- Approve, monitor and review company performance
- Protect and represent the interests of shareholders as a whole

Responsibilities of the Board of Directors

- Set the appropriate strategic direction for the company, in conjunction with the Management Team
- Review, approve and monitor the strategic and annual business plans on an ongoing basis
- Review financial performance against targets, including benchmarking against competitor performance
- Ensure that the Management Team consistently adheres to and implements policy and procedure as advised
- Monitor legal, ethical, risk and environmental compliance
- Allocate responsibility for specific tasks to Board members
- Draw up a schedule of matters specifically reserved to it for decision, e.g.
 - Issue of new capital
 - Borrowings
 - Acquisitions/divestments
 - Dividend policy
- Remuneration of Non Executive Directors. Under the Combined Code (2003), the Remuneration Committee (made up of Non Executive Directors) is responsible for the remuneration of Executive Directors and the Chairperson. Remuneration of Non Executive Directors is a matter for the Board or, if required by the Articles, the shareholders
- Appoint and remove the Managing Director/ Chief Executive and plan for orderly succession
- Monitor and review the performance of the Management Team and its individual members
- Hire, advise, compensate, and, if necessary, remove members of the Management Team
- Ensure that the financial records are audited in accordance with accepted accounting standards and policies

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- Approve the financial statements for each financial year which give a true and fair view of the state of affairs of the company
- Hold an annual general meeting with company shareholders
- Hold Board meetings on a regular basis
- Meet with the Management Team at least once a year to review the strategic direction of the company
- Share responsibility for Board decisions (whether present at the Board meeting or not). As individuals, Directors have no specific powers to make decisions or take actions on their own

Insights and practical suggestions

Successful Boards

- The success of the Board will depend on the personalities involved and how well they work with each other. Often the decision to join the Board of a company is influenced by the names of those on the Board, their reputation and whether one knows them or not
- Terms of Reference for the Board should be drawn up and agreed upon by the entire Board so as to prevent the abuse of power by an individual Director
- Demands on the Board are constantly changing and therefore, the Board's function, make up and talents should continually evolve with the company to remain effective
- Directors who serve on too many Boards will dilute the contribution they can make to any one individual Board. The Combined Code directs that no full-time Executive Director should be appointed to a second Non Executive Directorship or chairmanship of a FTSE 100 company
- Although the Board is responsible for ensuring that the Management Team runs the company efficiently, it should not become overly involved in the running of the company except when serious operational issues arise
- Visibility of Board members around the company builds up the credibility of the Board and will help Board members to learn more about the company
- The Board should ensure that the Management Team considers the key risks to which the business is exposed, and put in place a plan of action to address them
- The manner in which Non Executive members of the Board challenge the executive members is important for Board harmony. For example, if the questioning is inappropriate, Executive Directors can build up a resistance to the Non Executive Directors which can be to the detriment of the Board
- Lunch or dinner after a Board meeting provides a good opportunity to build relationships among Board members who may not otherwise meet in an informal setting

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Board representation

- The Board can be made up of a number of:
 - Executive Directors (see Section 3.6), representing the Management Team and providing in-depth knowledge of day-to-day operations
 - and/or
 - Non Executive Directors (see Section 3.5), bringing an independent and challenging perspective and enhancing the decision-making process
- A balance should exist between the number of Executive Directors and Non Executive Directors, so that no individual or group of individuals can dominate the Board. There are differing views as to the appropriate balance of Executive Directors and Non Executive Directors
 - According to the Combined Code (July 2003) at least half of the Board (excluding the Chairperson) in a listed company should be comprised of Non Executive Directors who are considered independent
 - In the case of smaller listed companies two Non Executive Directors are recommended
 - Whilst not a requirement for an unlisted company, a Non Executive Director can nonetheless be a useful Board member
- The Board should consist of members with diverse backgrounds and knowledge, with a balance of skills and experience to support the strategic objectives of the company
- In the absence of a Nomination Committee, the Managing Director/ Chief Executive and Chairperson must work together with the Board in deciding on an appropriate recruitment process for Directors

Managing Director/ Chief Executive succession

- Managing Director/ Chief Executive succession is a high priority for a Board. Primary responsibility for succession planning lies with the Board
- The Board is responsible (whether by itself or on recommendation from a Nomination Committee) for orderly succession, for appointments not only to the Board but also to its Management Team
- Historically, the Managing Director/ Chief Executive may have chosen his/her successor. Current best practice is that the Board should decide on an appropriate process for Managing Director/ Chief Executive succession
- The circumstances surrounding the retirement of the Managing Director/ Chief Executive will determine whether s/he should have an involvement in the process for selecting a successor

Board meetings

- The Chairperson and the Managing Director/ Chief Executive should communicate in advance of the Board meetings to discuss the agenda and any issues of concern. Some organisations hold an agenda meeting at which the Chairperson, the Managing Director/ Chief Executive and the Company Secretary meet a week or so in advance of the Board meeting to decide on the agenda and plan for the meeting. Advance circulation of the agenda and

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information (at least a week in advance of the meeting) is best practice for effective discussion

- The number of Board meetings required will depend on the stability of the business, the volatility of the market in which it operates and the confidence of the Board in the experience and skills of the Management Team
- Board meetings should be held as frequently and for a length of time that ensures meaningful engagement takes place

Key legal considerations

Directors' duties

- Directors are required to act in the best interest of the company. They have a wide range of both statutory and non-statutory duties.

The Companies Acts impose a number of duties and liabilities on Directors – for example s383(3) of the Companies Act 1963 (as inserted by s100 of the Company Law Enforcement Act 2001) provides that it is the duty of each Director and Company Secretary of a company to ensure that the requirements of the Companies Acts are complied with by the company

Liabilities of Directors are also laid down in other statutory enactments, including health and safety legislation and environmental legislation

- In addition to being required to act in the best interest of the company, a Director also owes a number of other fiduciary duties to the company in respect of which s/he is appointed

These include a duty of loyalty, of obedience to the company's constitution, of avoidance of secret profits, of independence of judgement, a duty to avoid conflicts of interest, duties of care, skill and diligence, a duty to consider interests of third parties and a duty of fairness

In relation to the duties of care, skill and diligence, a Director will owe the company such a duty as would be expected in the same circumstances by a reasonable person having both (i) the knowledge and experience that may reasonably be expected of a person in the same position as the Director and (ii) the knowledge and experience which the Director has. Accordingly, the experience and expertise of the Director (whether Non Executive or Executive) will determine the standard of care expected from such a Director

- Directors' duties were traditionally only owed to the company. In recent times, case law has seen this expanded to provide for Directors owing duties to creditors in the case of insolvent companies. Under the 1990 Companies Act, Directors are also required, in performing their functions, to have regard to the interest of the company's employees and members
- The Companies (Auditing and Accounting) Act 2003 will, when commenced, impose new demands on company Directors. New annual certifications will be required to be published by many Irish companies and their Directors regarding compliance with the law, accounting policies and relations with auditors. Audit Committee requirements will apply to many public limited companies and large private companies (unless such private companies explain publicly why they

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have not established such a committee). The accounts of certain types of company will be the subject of oversight by a new accounting and audit regulator (IAASA) to ensure compliance with the Companies Acts. All of these requirements will carry criminal penalties for default, including penalties applicable to Directors

- In the future, Directors of certain companies will, under the 2003 Act, be required to prepare a compliance statement (which is to be included in the Director's report filed with the annual accounts) regarding the company's policy in relation to compliance with relevant obligations (which are defined to include the Companies Acts, tax law and enactments in which the company operate and which could materially affect the company's financial statements). The Directors must also set out in this statement the procedures that have been put in place within the company to ensure compliance with these obligations, and the arrangements for implementing and reviewing the effectiveness of these policies and procedures. The Directors' Compliance statement must be in writing, approved by the Board, reviewed and, if necessary, revised at least once in every three-year period. The company's auditors will also be required to assess the fairness and reasonableness of this statement

These Directors will also be required to include an additional statement in their Directors' Report accompanying their company's accounts (known under the 2003 Act as a 'related statement'). This statement acknowledges the Directors' responsibility for securing compliance by the company with its relevant obligations, confirms that the necessary procedures designed to achieve compliance with such obligations are in place, and that the effectiveness of such procedures has been reviewed

Directors' Liability

- As an officer of the company, a Director can be liable to be penalised as being an 'officer in default' where the company defaults in the duties that are imposed on it under the Companies Acts 1963-2003
- Personal liability can be imposed upon the Directors of a company in a number of situations under the Companies Acts, including that where a Director is concerned, with fraudulent or reckless trading or where the company fails to keep proper books of account
- Where a Director is guilty of negligence in the context of his/her office, s/he can be liable to the company for the damages that result. The liability may be enforced against him/her in the ordinary way by action brought by the company. Directors are entitled as agents of the company to be indemnified by the company in respect of any liabilities incurred by them in the management of the company's business

Directors' & Officers' (D&O) Insurance

- D&O Insurance offers protection for Directors and Officers of the company against claims arising in the performance of their business duties

The D&O policy may be considered a type of Executive Malpractice Policy

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which responds to allegations of 'wrongful acts' brought against the Directors and Officers of the company. A wrongful act is usually defined as a breach of duty, neglect, misstatement, error and omission by Directors or Officers while acting in their capacity as such

- In light of recent events, Directors and Officers are being exposed to potentially greater risks of litigation due to lower investor tolerance for performance and governance failures. Lacking sufficient D&O coverage, Directors and Officers are dependent on their organisation's ability to protect them if they are held liable. However, due to the increased severity of claims, Directors and Officers face a greater risk because companies (particularly small and medium enterprises) may not be financially able to protect them for the large costs involved in today's litigation. The Combined Code 2003 provides that listed companies should arrange appropriate insurance cover in respect of legal action against their Directors
- The ability of an Irish company to indemnify (which prior to the Companies (Auditing and Accounting) Act 2003 would also have extended to the taking out and funding of D&O Insurance) an officer is severely restricted under Irish law.

Section 200 of the Companies Act 1963 extensively limits the ability of a company to indemnify an officer in respect of liabilities which occur in managing the business. Section 200 only allows for indemnities where liability is incurred by a Director in successfully defending proceedings or following an acquittal, or where the Director obtains relief from the courts under Section 391 of the Companies Act 1963 (Section 391 permits a court in certain circumstances to absolve an officer from liability where s/he acted honestly and ought fairly to be excused)

- Section 56 of the Companies (Auditing and Accounting) Act 2003, now commenced, amends Section 200 of the 1963 Act by specifically allowing a company to take out Directors' and Officers' insurance policies relating to potential civil liability for negligence, default, breach of duty or breach of trust. Section 56 also confirms the validity of any previous Directors' and Officers' insurance policies taken out by a company, as to date there have been doubts over the validity of such policies
- There are a wide variety of D&O policies. Directors should evaluate the cover which is provided by various companies and should understand what is covered, and more particularly, what is not covered before committing to a policy. In addition to understanding the policy, Directors should understand how it relates to them on joining, serving and leaving a company. D&O insurance has become a highly technical area and relevant advice should be sought before taking out such a policy

10 Questions a Director should address before accepting a Non Executive Directorship:

- 1 What information and knowledge do I need to know about the company and the industry?
 - (a) Strategic plan
 - (b) The company's marketplace
 - (c) Developing trends and related forecasts
 - (d) Regulations governing the industry
 - (e) Accounting and reporting methods used within the industry
 - (f) The risks within the industry

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- 2 How has the company performed over the last three years and what are its plans for the future?
- 3 What is the company's record in relation to Corporate Governance?
- 4 What are the competencies, capabilities and weaknesses of the Board, and how can I complement them?
- 5 What would my role be on the Board?
- 6 How can I add value to the company?
- 7 What time commitment will the position require?
- 8 What risks am I potentially exposing myself to?
- 9 How are members of the Board and Management Team perceived by the business community?
- 10 If I accept this position, will it conflict with any other appointment I have?

10 Questions to be considered by the Board in recruiting a Director:

- 1 Has the Board developed a written Director job description? Such a description should be as detailed as those for any top Management Team position
- 2 Are these Board job descriptions customised for each Board position, specifying some target skills and assets unique to each?
- 3 Who is responsible for suggesting Board candidates? Is it the Chairperson, the Managing Director/ Chief Executive, the Board, a committee of the Board, or a combination of people?
- 4 Does the Board search process consider diversity needs, such as gender, racial or ethnic? Can the Board target any strategic needs that could be addressed through greater diversity?
- 5 Are the Board's recruiting targets aimed at a certain executive level or above?
- 6 Do the Board members have skills that the company can grow into (experience with a larger company than your own or with your future markets)?
- 7 What information do we need to provide to encourage Non Executive Directors to join?
- 8 Have we given the candidate exposure to several of our current Directors for informal discussion, both to gain a variety of views on the candidate and to let the prospective Director judge the chemistry of the Board?
- 9 Does the Board have a policy on the recruitment of Directors from management?
- 10 What channels should we use to recruit a new Board member?