

# Role of the board

## *Governance relations*

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

It includes:

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

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

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

- Providing strategic direction to the organisation and deciding upon the organisation's strategies and objectives in conjunction with the CEO;
- Monitoring the strategic direction of the organisation and the attainment of its strategies and objectives in conjunction with the executive;
- Monitoring the operational and financial position and performance of the organisation generally;
- Driving organisational performance so as to deliver member value or benefit;
- Assuring a prudential and ethical base to the organisation's conduct and activities having regard to the relevant interests of its stakeholders;
- Assuring the principal risks faced by the organisation are identified and overseeing that appropriate control and monitoring systems are in place to manage the impact of these risks;
- Reviewing and approving the organisation's internal compliance and control systems and codes of conduct;
- Assuring that the organisation's financial and other reporting mechanisms are designed to result in adequate, accurate and timely information being provided to the board;
- Appointing and, where appropriate, removing the CEO, monitoring other key executive appointments, and planning for executive succession;
- Overseeing and evaluating the performance of the CEO, and through the CEO, receiving reports on the performance of other senior executives in the context of the organisation's strategies and objectives and their attainment;

- Reviewing and approving the CEO's and, in conjunction with the CEO, other senior executive remuneration;
- Approving the organisation's budgets and business plans and monitoring major capital expenditures, acquisitions and divestitures, and capital management generally;
- Ensuring that the organisation's financial results are appropriately and accurately reported on in a timely manner in accordance with constitutional and regulatory requirements;
- Ensuring that the organisation's affairs are conducted with transparency and accountability;
- Overseeing the design, implementation and periodic review of appropriate and effective policies, processes and codes for the organisation, which depending on the organisation, may include with respect to ethics, values, conduct, securities trading, disclosure of securities' price sensitive information, employment, remuneration, diversity and otherwise;
- Ensuring sound board succession planning including strategies to assure the Board is comprised of individuals who are able to meet the responsibilities of directors of the organisation;
- Overseeing member and stakeholder engagement, reporting and information flows.

**What is the role of the board?**

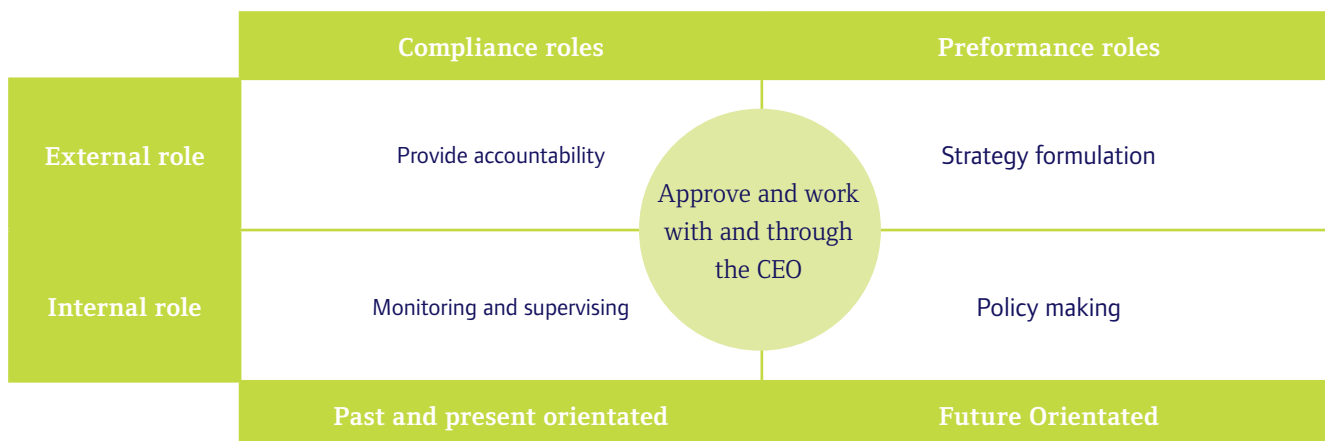
In practice, the role of the board including governing, directing and monitoring an organisation's business, affairs and operations in two broad areas.

**Overall organisational performance:** ensuring the organisation develops and implements strategies and supporting policies to enable it to fulfill the objectives set out in the organisation's constitution. Commonly the board delegates the day to day operations of the organisation to the management team via the CEO but remains accountable to the members and shareholders for the organisation's performance. The board monitors and supports management in an on-going way.

**Overall compliance/conformance:** ensuring the organisation develops and implements systems, processes and procedures to enable it to comply with its legal, regulatory and industry obligations (complying with the law and adhering to accounting and other industry standards) and ensure the organisation's assets and operations are not exposed to undue risks through appropriate risk management.

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

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



### The board's role in the organisation's governance

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

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

In Australia, corporate governance of ASX listed public companies operates on an if not, why not approach rather than mandatory detailed regulation as is more common in the USA. This approach means that, in general, a company does not have to comply with the ASX Corporate Governance Council's (ASXCGC) *Corporate Governance Principles and Recommendations 3e* (2014), but, if it does not, then it must disclose in its annual report or other public statement on its governance why not. This approach is seen as the best way to provide guidance but at the same time to allow the necessary flexibility.

### Getting the right skills on the board

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

It is important to select board members who have sufficiently broad experience in the issues and opportunities the organisation is facing now or is likely to face in the future. While specific skills required by each board differ, there are some core skills that should be represented on a board as a whole (not necessarily in one person).

These include:

- Strategic expertise – the ability to set and review strategy through constructive planning, questioning and suggestion;
- Accounting/Financial literacy – the ability to read and comprehend the accounts and the financial material presented to the board, in addition to understanding financial reporting requirements – the Centro case (ASIC v Healey (2011)) has emphasised the need for basic financial literacy for all board members;
- Legal skill – the ability to understand and oversee compliance with numerous laws;
- Managing risk – experience in risk management and mitigation principles;
- Human resource skills – experience in human resource management;
- Marketing and communications – experience in media and marketing;
- Industry knowledge – experience in similar organisations or industries;
- Information technology – there is a growing need for directors with an understanding of information and communication technology;
- Capital markets experience – experience in capital raising and mergers and acquisitions.

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

As diversity of perspective is seen as a valuable addition to a board's deliberations, boards should have a diversity policy which has measurable objectives for achieving diversity including diversity of gender, age, ethnicity and life's experiences.

### Board decision making?

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

### What are board committees?

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

There are specific requirements for companies within the S&P/ASX All Ordinaries Index and the S&P/ASX 300 Index in relation to audit committees. Listing Rule 12.7 requires a company in the S&P All Ordinaries Index at the beginning of its financial year to have an audit committee during that year. If the company was in the S&P/ASX 300 Index at the beginning of its financial year, it must follow the recommendations of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations 3e* (2014) on the composition, operation and responsibility of the audit committee.

Boards have discretion to adopt or reject a board committee's recommendations or to refer the decision back to the committee for re-consideration. If the board delegates the formal exercise of any of its powers to a committee, it is important to note that the board and its directors remain responsible for the exercise of power by that committee, subject to any fair delegation defences that may be available (for example, for companies registered under the *Corporations Act 2001* refer s 190)

### The board's role in selecting a CEO

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

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

### The board's role in strategic planning

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

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

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

Generally management has the responsibility to implement the strategy so it is important that the key executive management personnel support it.

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

Developing and communicating a clear strategy for the organisation can help to build stakeholder and investor confidence.

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### The board's role in setting ethical standards?

Compliance with the law is the minimum standard for running an organisation. There are ethical values which should govern the way in which an organisation operates. It is now widely accepted that inculcating those values in an organisation's culture is an essential role for the board. For example Principle 3 of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations 3e* (2014) is that “a listed entity should act ethically and responsibly”.

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

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

## The role of the board in APRA-regulated organisations?

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

People who have been unwilling to comply with legal obligations, have breached fiduciary duties, been negligent or deceitful, have been disciplined, disqualified or subject to an enforcement action by a professional or regulatory body regarding honesty and integrity, have been substantially involved in a business failure or held in bad repute in a business community are deemed to not be fit and proper. APRA expects an annual review of a person’s fitness and propriety. See, for example, Prudential Standard CPS 520 'Fit and proper' (January 2013).

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