AUSTRALIAN INSTITUTE *of* COMPANY DIRECTORS

DIRECTOR TOOLS

Board committees

Role of the board

The boards of larger organisations often delegate work to committees of directors to more effectively deal with complex or specialised issues and to use directors' time more efficiently. Committees make recommendations for action to the full board, which retains collective responsibility for decision making.

Involvement in committees allows directors to deepen their knowledge of the organisation, become more actively engaged and fully utilise their experience. Additionally, the existence of committees can indicate to investors that the board is taking particular issues seriously.

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

Smaller companies may not benefit from a formal committee structure because their boards are often quite small and operations not as complex. Companies without board committees should have board processes in place which cover the issues that would otherwise be considered by the relevant committees.

What is required by law and the regulators?

Corporations Act 2001

Section 198D of the *Corporations Act 2001* ('Act') allows boards to delegate some of their powers to a committee of directors unless the company's constitution disallows it. The delegation must be recorded in the minute book.

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

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

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

ASX Corporate Governance Council's Corporate Governance Principles and Recommendations

The ASX Corporate Governance Council *Corporate Governance Principles and Recommendations 3e* (2014) ('ASX Recommendations') recommends boards establish three committees – audit, remuneration and nomination. In addition, it recommends that boards should have a committee or committees to oversee risk. In some cases, this function is combined with the audit committee. In other cases, it is a standalone committee of the board. Each of these types of committees is discussed in more detail below.

The ASX Recommendations work on an 'if not, why not' basis, meaning that they are generally not mandatory but listed companies who do not comply with them must explain in their annual report why they have not.

It should be noted, however, that there are mandatory requirements in relation to audit committees and remuneration committees which are discussed below.

Each of these committees should have a charter clearly outlining their responsibilities. The ASX Recommendations also provide guidance as to the information regarding the constitution of the committee and its activities that should be contained in the annual report.

Australian Prudential and Regulation Authority (APRA)

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

What are the most common committees?

Every board will have to decide for itself which committees will add most value to their organisation subject to the mandatory requirements discussed below. Committees may be of an ongoing nature like the audit committee, usually referred to as standing committees, or may be formed for a specific short term project or goal.

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

Audit Committee

The audit committee is one area where there are some mandatory requirements. First, ASX Listing Rule 12.7 requires that a company which was included in the S&P All Ordinaries Index at the beginning of its financial year must have an audit committee during that year.

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

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

Some of the recommendations under Recommendation 4.1 of the ASX Recommendations which must be complied with include:

- Structure – at least three members, only non-executive directors, majority of independent directors, independent chair who is not chair of the board.
- Charter – the committee should disclose the charter of the committee.
- Meetings – the committee should disclose the number of times it met throughout the year.
- Minutes – minutes should be kept and circulated to the full board.

There are similar requirements for institutions which are regulated by APRA (see for example Prudential Standard CPS 510 'Governance', effective from 1 January 2013).

The main functions of the audit committee include:

- ensuring the adequacy and integrity of the company's financial reporting systems;
- monitoring and evaluating the adequacy of internal accounting controls;
- to reviewing and agreeing on the audit plan;
- to overseeing the appointment, performance and independence of the external auditor.

Remuneration Committee

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

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

For other companies, the ASX Recommendations apply on the usual 'if not, why not' basis. Recommendation 8.1 of the ASX Recommendations provides that remuneration committees should have a minimum of three directors, the majority of whom are independent, and should be chaired by an independent director.

The main functions of the remuneration committee include:

- to review policies and practices and make recommendations to the board in relation to remuneration, recruitment, retention and termination of directors, the CEO and senior executives;
- to ensure the company makes the necessary disclosure to the market regarding remuneration (in accordance with the requirements of s 300A of the Act);
- to be responsible for the adoption of the remuneration report (see s 250R and 250SA of the Act);
- superannuation arrangements;
- recommendations as to remuneration by gender.

Nomination Committee

The ASX Recommendations (Recommendation 2.1) provide that nomination committees should also have a minimum of three directors, the majority of whom are independent, and should be chaired by an independent director.

The main functions of the nomination committee include:

- to assess the board's and organisation's needs in terms of skills, knowledge and experience for directors, ceo and senior management and make recommendations to the board regarding appointments, retirements and terms of office;
- to assess and review directors' inductions, performance and development;
- to ensure proper succession planning for the board and key executives.

Risk Committee

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

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

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

- making recommendations to the board to improve the risk management framework;
- monitoring the significant risks of the organisation including the effective operation of risk mitigation strategies;
- making a contribution to the identification and evaluation of risks facing the organisation.

What goes into a committee charter?

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

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

Who are committee members?

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

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

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

How and what should a committee report to the board?

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

The minutes or a written report of the meeting should be included in the board papers for the next full board meeting. The information contained should reflect the needs of the full board, for example highlight the issues, options and recommendations for decision or approval.

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

Should the Committees Be Evaluated?

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

The Principles also require regular board performance evaluations (Recommendation 2.5), including a review of the performance of its committees.

Does sitting on a committee carry extra legal liability?

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

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

About us

The Australian Institute of Company Directors is committed to excellence in governance. We make a positive impact on society and the economy through governance education, director development and advocacy. Our membership includes directors and senior leaders from business, government and the not-for-profit sectors.

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