



CORPORATE GOVERNANCE

CORPORATE GOVERNANCE ISSUES AFFECTING SMEs



Paper 013-001


CONTENTS


	<u>Page</u>
1. What Is A Director?	2
2. Director's Duties And Responsibilities	2
3. Act Diligently And Honestly.....	3
4. Directors' Due Diligence Requirements.....	4
5. Persons Prohibited From Being Directors.....	4
6. Use Of Information.....	5
7. Insolvent Trading	5
8. Financial Difficulties	5
9. Workplace Health And Safety Issue	6
10. Director's Checklist.....	6
11. Minutes Of Meetings	6
12. Action List From Directors' Meetings	7
13. Copies Of Board Reports.....	7
14. Director's Own Notes/Records Of Meetings	7
15. Director's Diligence.....	8

CORPORATE GOVERNANCE

CORPORATE GOVERNANCE ISSUES AFFECTING SMEs



Paper 013-001



1. What Is A Director?

Directors of a company are the key people expected by Law to administer the company. For a proprietary company a minimum of one Director is required and for a public company the minimum is three Directors.

The control of a company is normally given to Directors through the Constitution. The Directors are able to delegate their responsibilities through the employment of management personnel to manage various aspects of the business. In particular, the Directors need to give detailed consideration to the appointment of a Chief Executive Officer (CEO).

The Directors need to ensure that adequate consideration has been given to the appointment of appropriately qualified and experienced persons to manage key aspects of the business.

2. Director's Duties And Responsibilities

The Director's responsibilities are to ensure the smooth running of the company. Whilst many of these duties can be delegated to management, overall the Directors are still responsible. Directors should ensure that meetings are held regularly so that all Directors are adequately informed of what is happening in the company. The Directors should insist on receiving written reports on matters to be discussed at a Directors' meeting and the agenda for that meeting at least forty-eight hours prior to the meeting so they can brief themselves on the matters to be discussed.

The Directors should also insist that adequate consideration has been given to the appointment of management personnel to manage the company, for which the Directors are ultimately responsible.

There are many other items for which the Directors are responsible. These include:

- purchasing of assets in the company's name;
- obtaining good title to the assets being purchased;
- negotiating reasonable borrowings to assist in financing the company's operation;
- establishment of a system for the company to enable the orderly purchasing of goods and services;
- establishment of a system to ensure that proper control is established for the purchase of stock:
 - identification of any products that the enterprise sells which are GST free;
 - identification of any products or services which are input taxed supplies;
 - has management implemented systems to identify those business inputs, which are not eligible for input tax credits because the product or service is input taxed supplies? i.e. input taxed items;

- have adequate systems been implemented for the preparation of the company's Business Activity Statement?
- have systems been introduced to ensure that displayed prices include GST?
- control of debtors' accounts;
- preparation of accurate financial accounts;
- preparation of Budgets and Cashflow Forecasts;
- payments to suppliers within agreed payment times;
- preparation of income tax returns;
- establishment of a system of internal control;
- establishment of a system of quality assurance;
- preparation of the company's business plan;
- ensuring that adequate staff training systems have been implemented;
- agreeing on the duties of the Chief Executive Officer or Managing Director of the business;
- ensuring that regular management meetings are held throughout the company;
- ensuring that the Directors are kept informed of any environmental issues affecting the company's operations;
- ensuring that the company's Directors are kept informed of any legal breaches that have been incurred by the company;
- ensuring that the company's assets have been adequately insured;
- preparation of an annual report to shareholders;
- ensuring that all legal requirements that the company has are properly adhered to;
- ensuring that Directors are promptly informed of any creditor payments not made within the creditor's stipulated payment terms or any other payment not made on, or before, the due date for payment.

Directors' duties and responsibilities are therefore very wide and onerous.

3. Act Diligently And Honestly

Directors are required to act in a diligent and honest manner in the exercise of their powers and the discharge of their duties.

Directors must exercise a degree of care and diligence that a reasonable person in a similar position in a company would exercise in similar circumstances.

A Director should ensure that he/she is adequately informed and understands the company's operation and how the business is performing.

Directors need to make their own enquiries in relation to proposals that have been put forward by management.

Directors are not merely a "rubber stamp". They have to become informed as to the company's operations and the state of the industry in which the company is operating.

If a Director does not understand a technical matter submitted to the Board of Directors for consideration, the Director should state this and request that a technical expert is engaged to fully explain the matter to the Directors, so they can understand the overall implications of a particular proposal, from the company's point of view.

Directors should act honestly and should not use their position as a Director to improve their own financial position.

4. Directors' Due Diligence Requirements

The Law expects Directors to be diligent in the discharge of their duties. This means that they should:

- Obtain information in relation to the operations of the company.
- Inspect factories, retail shops, warehouses, outlets and business premises owned, leased or otherwise occupied by the company.
- Attend Board of Directors' meetings and be an active participant in those meetings.
- Ensure that management is adequately reporting to the Board of Directors and are not using the Directors as a "rubber stamp".
- Ask questions and enquire as to the meaning of various matters submitted in reports to the Directors.
- Ensure that management is adhering to the company's business plan.
- Review Key Performance Indicators, Periodic Financial Reports and the Budget and Cashflow Forecasts to ascertain whether the company is performing in a satisfactory manner.
- Directors need to ensure that the financial accounts, comprising Balance Sheet and Profit and Loss account, have been accurately prepared. Directors should be especially diligent to the correct allocation of items within the Balance Sheet, particularly current liabilities and non-current liabilities. In June 2011, the Federal Court made a very important judgement on Directors' duties in the Centro Group properties case. The court decided that it is the Directors' responsibility to ensure that there has been correct treatment of items within the Balance Sheet. The case arose over a challenge as to the treatment of some liabilities, which the court has decided should have been treated as current liabilities and not long term liabilities. The court found *"that the directors failed to take all reasonable steps required of them, and acted in the performance of their duties as Directors without exercising the degree of care and diligence the law requires of them"*. Even though this court case involved a major public company, decisions made in cases such as this relate to all companies. Therefore this judgement needs to be reviewed by all company Directors as it emphasises the very important aspect of company Directors' duties in that the Directors are signing off on the financial accounts and therefore need to have satisfied themselves that the financial accounts have been correctly prepared.
- At all times be aware of the company's requirements not to trade whilst insolvent.
- If unsure, insist that the board appoints an external expert to advise the Directors on any particular technical issue that has been submitted to the Directors for their approval.

5. Persons Prohibited From Being Directors

- Anyone under the age of eighteen.
- Persons who are insolvent under administration (unless they have received consent of the Federal Court or the Supreme Court of a State or Territory).
- Anyone who has been convicted of an offence against any Law in connection with the promotion, formation or management of a company or serious fraud, punishable by imprisonment for at least three months.
- Fellow Directors should ensure that no person, who is disqualified from being appointed a Director, is appointed a Director of the company.

6. Use Of Information

Directors should ensure they only use any information received by them, in their capacity as a Director of a company, for the benefit of that company. They should ensure they do not use the information, either directly or indirectly, to benefit themselves or any other person, or to cause it to be used to the detriment of the company.

7. Insolvent Trading

This is an area about which Directors need to be very diligent. That is, to ensure that the company does not trade whilst it is insolvent.

Insolvent trading means that the company continues to trade with the public and continues to incur further debts, whilst the company is unable to meet its existing debts or will be unable to pay the current debts being incurred.

Every company Director has a duty to ensure that the company does not incur a debt, if there are reasonable grounds for suspecting that the company is insolvent at the time the debt is incurred, or would become insolvent by incurring the debt.

The test of solvency is - can the company pay all its debts as and when they become due and payable?

Directors need to satisfy themselves that the management team is capable of producing regular, prompt, accurate financial reports so that the Directors can satisfy themselves that the company is not trading whilst it is insolvent. The minutes of Directors' meetings should record that the Directors examined the solvency of the company and, following a review of management's reports, were satisfied of the company's solvency position.

8. Financial Difficulties

There are numerous reasons for financial difficulties. Directors should be aware of these so they can ensure that appropriate action is taken to prevent the company trading whilst insolvent.

These include:

- Low operating profits or losses being incurred.
- Problems with paying creditors in accordance with the negotiated payment terms.
- Problems with meeting loan repayments to banks, financial institutions and other lenders.
- Problems with paying income tax instalments or GST.
- Suppliers refusing to give the company credit.
- Legal action being instigated against the company by any supplier for the non-payment of goods or services.
- High debtors' amounts owing above the amount that the company has budgeted.
- High stock or work in progress investments above the amount that the company has budgeted.
- Excessive investment in capital expenditure, especially if it was not budgeted for.
- Departure from the Budget or Cashflow Forecast prepared for the business.

9. Workplace Health And Safety Issue

The Workplace Health & Safety Act imposes obligations on company officers to exercise due diligence to ensure the person conducting a business or undertaking (PCBU) is complying with the Act.

- Due Diligence – What Steps Should Be Taken – company Directors and other company officers, which can include managers, need to acquire knowledge of occupational health and safety matters.
- There is a need for company officers to gain an understanding of the hazards and risks associated with the work to be undertaken – before work commences.
- Company officers need to ensure appropriate resources and processes are available to eliminate or minimise risks.
- Officers need to ensure there is a reporting process for health and safety issues.
- If the company officer delegates, he/she must ensure they have delegated with proper due diligence, ensuring that the person to whom they have delegated is appropriately trained and to regularly monitor the performance of that person. In other words, you cannot just say that you have asked someone to be responsible for it and not take any further notice.

There are severe penalties under *The Workplace Health & Safety Act*.

- Category One – recklessly exposing of the person to risk of death or serious injury or illness
 - \$3M for corporations
 - \$600,000 for individual
 - Five years imprisonment
- Category Two – serious risk of harm without recklessness
 - \$1.5M for corporations
 - \$300,000 for individual
- Category Three – fails to comply with Workplace Health & Safety duties
 - \$500,000 for corporations
 - \$100,000 for individual

10. Director's Checklist

A Director's Checklist is a list of the items on which a prudent diligent Director should be receiving reports, or on which appropriate management action has been taken, so that the Board of Directors can satisfy themselves that management is capably managing the company.

Items to be included in a checklist are outlined in [Paper 013-005 - Director's Checklist](#).

11. Minutes Of Meetings

The company secretary or some other person nominated by the Board of Directors should be responsible for the preparation of minutes of each Directors' meeting and an action list.

The minutes should state:

- date and time of the meeting;
- names of Directors and any other persons present at the meeting;
- time that a Director entered the meeting after the meeting had commenced;
- time that any Director or other person left the meeting before it concluded;
- names of any apologies submitted;
- the motion for confirmation of the minutes of the previous meeting;
- action on any items left over from the previous meeting;

- each report considered by the Directors;
- all resolutions of the Board of Directors;
- if a motion was not carried unanimously, then the names of the Directors in support of the motion and those against the motion should be recorded; and
- the time that the meeting closed.

Each Director should insist on receiving a copy of the minutes within five days of the meeting being held so they can ensure the Director is happy with the recorded minutes and that any follow-up action, which has been assigned to them, can be implemented.

12. Action List From Directors' Meetings

Attached to the minutes of each Directors' meeting should be an action list that has been prepared by the company's secretary or the person who prepared the minutes. The action list should detail items that were considered during the meeting and that are noted in the minutes as requiring follow-up action.

The action list should record:

- reference number for the individual item;
- a brief description of what the item is about;
- the name of the person allocated to do the follow-up work; and
- the date the report is to be re-submitted to the Board of Directors.

By preparing an action list to accompany each set of minutes, the company will be ensuring that there is prompt follow-up action on all items raised at a Board of Directors' meeting.

13. Copies Of Board Reports

It is desirable that Directors maintain their own files on the reports submitted to them at the Directors' meetings.

Recent court cases have highlighted the undesirability of Directors handing their board papers back to the Company Secretary at the end of a meeting.

14. Director's Own Notes/Records Of Meetings

Directors can be placed in the very awkward position some years later of defending decisions made at Directors' meetings. In all possibility, the defence will be required in a court case.

For these reasons, Directors should prepare their own notes on each meeting and confirm in writing to the Chairman any concerns or subsequent queries they have on any aspect of the Directors' meeting or questions relating to the company's operations.

Directors should consider maintaining a filing system whereby they maintain all board papers, minutes, file notes. Director's own record of meetings and correspondence should be held for, at least, seven years after a Directors' meeting. Obviously, if any party has started any type of enquiry or legal action, the records should be maintained until that action and any appeal period is at an end.

15. Director's Diligence

All of these items have been mentioned so as to highlight the high degree of diligence that Directors should be exercising for their company and themselves in carrying out their duties as a Director.

AN IMPORTANT MESSAGE

The forms and commentaries contained in this paper are provided as a guide only and should not form the sole basis for any advice in relation to the particular situation of any person without first obtaining proper professional advice.

This paper is provided on the understanding that ESS BIZTOOLS Pty Ltd (ACN: 078 451 439) will not be responsible as a result of any use made by users hereof of the forms or commentaries of this paper without first obtaining specific professional advice. Neither shall ESS BIZTOOLS Pty Ltd be responsible for any errors or omissions contained in these papers. ESS BIZTOOLS Pty Ltd expressly disclaims liability whether under contract or negligence and whether to a direct purchaser of these papers or to any other person who may borrow or use them in respect of any loss or damage flowing therefrom whether direct or consequential. In particular and without limiting the extent of this disclaimer ESS BIZTOOLS Pty Ltd accepts no liability if any form or commentary contained herein, whether used in its original form or altered in some way by the user, proves not to be valid or not to attain the end result desired by the user. This exclusion shall extend both to the user and to any client of the user who may suffer loss as a result of the use of these papers and it shall apply even though ESS BIZTOOLS Pty Ltd may have been negligent in the publication or preparation of these papers. The user acknowledges that it has not made known to ESS BIZTOOLS Pty Ltd any particular purpose for which these papers are required and that it has not relied on ESS BIZTOOLS Pty Ltd's skill or judgement to provide a paper suitable for any such purpose.

INTELLECTUAL PROPERTY NOTICE

The authority to use all copyright, trade marks and other intellectual property rights comprised in this paper is held exclusively by ESS BIZTOOLS Pty Ltd (ACN: 078 451 439). Neither these rights nor any part of this paper may be used, sold, transferred, licensed, copied or reproduced in whole or in part in any manner or form whatsoever without the prior written consent of ESS BIZTOOLS Pty Ltd (ACN: 078 451 439).