The essentials of being a director

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This guide is intended to provide company directors and prospective directors with a quick reference and overview of some of the key things they should think about. It outlines some of the legal requirements, ethical considerations and best practice areas for directors to consider, to be effective in their role. It is not intended to be comprehensive and includes links to more detailed resources.

Being an effective director

Good corporate governance supports investor confidence. To enable companies to grow and thrive, directors need to be both risk managers and responsible risk takers. Being a director is more than just a title. The office of a director carries with it a wide range of ethical, legal and commercial duties and obligations.

Company law requires directors to act in the best interests of the company (subject to certain exceptions). To that end, a director is the representative of the company and shareholder, and answers to them. Even if you're also the main shareholder, as a director you have legal obligations to actively monitor the management of your company, and you may face serious penalties if you fail to fulfil these obligations. The board of directors needs to balance its accountability to shareholders with responsibilities to other stakeholders.

The good news is that by being alert to the risks and realities of what is happening around you, and thinking for yourself, you'll already be performing important duties and responsibilities as a director. Equally, directors who consider the interests of stakeholders such as employees and customers will further the interests of the company and its shareholders.

Essential duties and responsibilities as a director

- Act honestly and with integrity.
- Act in the best interests of the company (subject to limited exceptions).
- Have the right mix of skills and experience to add value.
- Understand risk, and be responsive to risks and conflicts.
- Ask the hard questions until you're satisfied you can make a decision.

"There has never been a more exciting and challenging time to be a director. The landscape in which organisations are operating is demanding and constantly changing. Contributing factors include globalisation, geopolitics, rapid advancements in technology, disruption to business models, climate change and shifting demographics.

Corporate conduct and ethical behaviour are under increasing scrutiny, and investors and stakeholders are becoming more vocal in airing their concerns and aspirations. Directors have a key role in maintaining and growing trust and confidence in business and its role in society.

High-performing, effective, influential and progressive directors who are skilled in corporate governance focus on excellence and best practice to maximise value and performance. It means going beyond a compliance approach and aspiring to meet the highest standards of the profession."

The Four Pillars of Governance Best Practice (2018)

Before you take up a directorship

Make sure you have the time

- You can only add value if you can commit the time required to professionally carry out your duties.
- In addition to the regular schedule of board meetings and the preparation time for these, there may be spikes in activity as the board and management deal with particular issues. You'll need to be able to accommodate irregular time demands.

Get to know the company and its markets

- What are its overarching objectives? How does it make money? How will it grow? Who are its competitors? How is it faring in the market? How are internal and external risks managed?
- Find out about the management team and other directors. Ask for CVs. Search LinkedIn profiles. Will your skills and experience add value? It's essential the board operates as a team with each member contributing fully.
- Review the company accounts, forecasts and constitutional documents. Consider whether you need some independent advice from a mentor or trusted advisor.

Understand the responsibilities a directorship involves

- Ask the chair and other directors what skills and focus the board is expecting you to bring. Assess whether you'll be able to provide what is required.
- You'll be in a governance role, not management. Make sure you understand the difference.
- Become familiar with the legal framework the company operates within. You may be personally responsible and liable for decisions.
- Ask about indemnities and Directors and Officers Insurance, and any prior or existing claims – otherwise you may be personally liable.
- Become familiar with the Financial Markets Conduct Act 2013 and Companies Act 1993 requirements, such as preparing and filing annual reports and returns, as well as director duties and responsibilities.

When you're working with other board members and management

Remember the big picture

- What are the long-term strategic direction and objectives? How do you build long-term sustainable value? How will internal and external conditions affect what you need to achieve? Check the details, but don't get caught up in them.

Do more than tick the boxes

- Being a director is not a box-ticking compliance exercise. Directors should recognise what must be done to support strategic objectives and take a business forward, and be able to adapt to circumstances where necessary. Make sure you comply with the law, but think, question and challenge too. Apply your skills and experience to help the company act honestly and with integrity.

Look for the bad news

- Even the best companies stumble sometimes. Corporate failures both in New Zealand and internationally should give directors some pause for thought.
- In considering your regular reports from management, keep an eye out for issues that might signal a problem. Follow up and find out more. Don't rely solely on management – you may need to seek further information, evidence or advice.
- It's up to boards to define their information requirements and point out where these are not being met by management. This should be raised as a priority.

> "Directors are entitled to delegate to others the preparation of books and accounts and the carrying on of the day-to-day affairs of the company. What each director is expected to do is take a diligent and intelligent interest in the information available to him or her, to understand that information, and apply an enquiring mind to the responsibilities placed upon him or her."
>
> **Australian Securities and Investments Commission v Healey [2011] FCA 717**

Ensure board minutes are an accurate record

Board and committee minutes are an official record of company proceedings. They are discoverable in legal proceedings, and courts will treat the contents of minutes as highly relevant. You should make sure the minutes reflect what occurred in the meeting, especially key decisions and difficult or complicated issues facing the company. Minutes are signed off by directors as a true and accurate record of the meeting. For more information see the IoD's ***Board Meetings Practice Guide***.

Learn from the annual review

- All boards should regularly review their performance, preferably annually. The review should be led by the chair. Boards should have rigorous formal processes for evaluating their performance and that of board committees and individual directors.
- There should be a regular (eg every other year) formal review of the chair.
- Reviews should assess skills and capability – both peer and self review is important, as well as external input and advice.
- Online appraisal tools such as the IoD's ***BetterBoards tool*** can help with the process.

Best practice and legal requirements

- Directors have a legal duty to "act in good faith and what the director believes to be in the best interests of the company" (section 131 of the Companies Act 1993).
- The Financial Markets Authority's ***2018 Corporate Governance Handbook*** highlights the importance of setting high ethical standards and having a balance of skills, knowledge, experience, independence and perspectives among directors so the board works effectively. The ***NZX Corporate Governance Code*** (NZX Code), the primary corporate governance practice guide for NZX-listed companies, also discusses ethical behaviour and what a code of ethics should include.
- The IoD's ***Code of Practice for Directors*** provides guidance to directors to assist them in carrying out their duties and responsibilities in accordance with the highest professional standards. This includes highlighting the importance of annual board reviews.

When you're making decisions

Apply your understanding of the company and the environment it works in

- Make sure you're familiar with key legislative requirements in your industry and sector.
- Make sure you're familiar with the industry and the environment it operates in. Understand the company's assessment of its long-term impacts on society and the environment, and the importance of maintaining a 'social licence to operate'.

Ask questions

- Prepare by reading papers before the meetings.
- Seek expert advice where necessary, but always test whether the advice is reasonable.
- How do the company's plans fit with its own policies, such as lending and credit policies, liquidity and provisioning?

Think for yourself

- Be alert to the risks of groupthink, and think for yourself. Where appropriate, challenge underlying assumptions and question statements. You're required to exercise your independent objective judgment and not be railroaded by others.
- Don't rely on others to make decisions for you.
- Directors can seek their own advice independent of management and other board members. You may wish to do so on problematic or critical strategic decisions, but you still have to make up your own mind.

> "If facts have come to the attention of a director that have awoken his suspicion that something is amiss...then the director has a duty to inquire into the matter. Further the director is not excused from making his own inquiries by relying on the judgement of others..."
>
> **ASIC v Flugge & Geary [2016] VSC 779**

Be aware of possible conflicts of interest

- You should avoid conflicts of interest so far as possible and act in accordance with the company's conflicts policy. Actual or potential conflicts should be declared and officially recorded as soon as they are identified. All companies should have an interests register and a process for managing potential conflicts. For more information, see the IoD's ***Conflicts of Interest Practice Guide***.
- Where you have a personal interest, you should avoid voting on related matters and generally avoid participating in related board discussions.
- Where you have an 'interest' in a transaction, you need to be able to show how the company (or the parent company if your constitution allows this) benefits and gets fair value from it – particularly if the transaction is not considered to be at arm's length.
- Check if your company constitution allows transactions with related parties. If so, do any special conditions apply and are they in the best interests of your company? Related party transactions are also likely to be material to investors and should be disclosed in any disclosure documents.
- Ensure you have a good understanding about what falls within the definition of a related party.

Apply the solvency test

- This is required under the Companies Act 1993 when entering into certain transactions and before making distributions to shareholders.
- You may need to sign a solvency certificate and be able to provide the reasons for your opinion that the company meets the solvency test.

The solvency test has two parts that must be satisfied

1. Liquidity or trading solvency – this requires the company to be able to pay its debts as they become due in the normal course of business.
2. Balance sheet solvency – this requires the value of the company's assets to be greater than its liabilities, including contingent liabilities.

Best practice and legal requirements

- Directors can rely on information and professional or expert advice, but only if they act in good faith, make proper inquiry and have no knowledge such reliance is unwarranted (section 138 of the Companies Act 1993).
- A director of a company may act in the best interests of that company's parent company (even though it may not be in the best interests of the company itself) but only if permitted to do so by the company's constitution (section 131 of the Companies Act 1993).
- Sections 139–149 of the Companies Act 1993 set out the requirements for transactions involving self-interest and section 4 defines the solvency test.

When you sign off financial statements

Read and understand them

- Make sure you read and understand the key financial statements – the balance sheet, income statement (profit and loss) and cash flow.
- Make sure you understand the content of the financial statements, including the accompanying notes.
- Carry out a careful review, examining in particular the key areas, and ask relevant questions to management and auditors.
- Check financial statements are consistent with other documents management has produced, and with your knowledge of the company's affairs.
- Check the disclosures. What are the most significant areas of judgment? Are these reasonable and clearly disclosed?
- Are there significant uncertainties about the ongoing viability of the business that need to be disclosed?

Don't sign off anything you're not comfortable with

- Don't sign off financial statements unless you're comfortable with the content.
- Read the director's representation letter carefully and ask the auditors to highlight any matters specific to your business.
- Be alert to what the external auditors say. If you're not sure, ask them to explain. Auditors only provide an independent opinion on the accounts – you're still responsible for signing them off as accurate.

Best practice and legal requirements

- Directors have a legal duty to exercise their powers and perform their duties with the care, diligence and skill that a reasonable director would exercise in the same circumstances. This includes taking steps to ensure you're properly informed about the financial position of the company and ensuring you understand your responsibilities taken on behalf of the company (section 137 of the Companies Act 1993).
- Principle 4 of the FMA's ***Corporate Governance Handbook*** highlights that the board should demand integrity in financial and non-financial reporting, and in the timeliness and balance of corporate disclosures. Principle 4 of the NZX Code also discusses disclosure of both financial and non-financial matters.
- The FMA's guidance on ***Disclosing non-GAAP financial information*** outlines the factors to consider when disclosing financial reporting measures that are not prepared or presented in accordance with applicable accounting standards.

If you're raising capital from the public

Learn the rules

- Various disclosure obligations must be complied with, including preparing a product disclosure statement and the Disclose register entry for the offer.
- Ongoing disclosure and confirmation obligations will apply.
- You should obtain legal advice, but you'll also need to satisfy yourself that the disclosure obligations have been complied with.

Make sure investors get an accurate picture

- Put yourself in the place of your investors. Does the information you have provided give a balanced view of the company? Is the information in the product disclosure statement written and presented in a clear, concise, and effective manner? Could an investor make an informed decision on whether or not to invest?
- Do the product disclosure statement and register entry include all material information about the offer?

Best practice and legal requirements

- Directors (and executives) thinking of going public and listing on the NZX can refer to the FMA's publication ***Going public, a director's guide.*** This guide helps directors and executives assess whether going public is appropriate for their company. It also outlines the process of becoming a public company.
- The disclosure obligations, including the requirements for product disclosure statements and register entries, are contained in the Financial Markets Conduct Act 2013 and Financial Markets Conduct Regulations 2014.
- The FMA monitors compliance with the disclosure obligations. Where obligations are not met, the FMA has broad powers including issuing stop orders that prohibit:
  - any offer, issue or sale of financial products
  - the acceptance of applications for financial products
  - the distribution of a product disclosure statement or advertisements relating to the offer of financial products.

If things go wrong

Keep an eye out for problems and warning signs

- Problems might range from conflicts within the board or with management through to issues such as fraud or insolvency.
- Monitor financial forecasts. Check underlying assumptions and consider whether they are realistic.
- Boards should ensure procedures are in place to prevent or minimise crises occurring, and should be alert to warning signs that can lead to a crisis.

Find out who to go to

- Talk with your chair and management, including your Chief Financial Officer.
- Get external advice from lawyers, accounting experts and other advisers. If the issue is serious, don't rely on company advisers – get your own legal advice.
- Alert the FMA if you feel investment offers are illegal or if financial markets legislation has been breached. Contact the Serious Fraud Office if you suspect fraud.
- Belong to a relevant membership organisation such as the IoD. This will help you develop networks you can use for mentoring and support.

> "ASIC does not allege ... that the directors needed to get it right ... All that is being alleged is that they should have detected the apparent error and acted accordingly by, for instance, asking the appropriate question of management."
>
> **Australian Securities and Investments Commission v Healey [2011] FCA 717**

Best practice and legal requirements

- Directors have a duty to not cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors (section 135 of the Companies Act 1993). This is in addition to the general duty to act in good faith and in the best interests of the company. It is also a criminal offence for directors to knowingly cause their company serious loss by acting in bad faith towards the company and believing that the conduct is not in its best interests (section 138A of the Companies Act 1993), or to dishonestly fail to prevent an insolvent company from incurring a debt (section 380(4) of the Companies Act 1993).
- Principle 1 of the FMA's ***Corporate Governance Handbook*** highlights that directors should set high standards of ethical behaviour, model this behaviour and hold management accountable for delivering these standards throughout the organisation.

If your company becomes insolvent

Stop trading

- If your company can't pay its debts when they are due, you must prevent your company from further trading. If you fail to do so you may be liable for civil penalties, compensation proceedings or criminal charges.

If you can't refinance or obtain funding to recapitalise, appoint the right person to take control

- It's critical that the board, not management, makes the appointment of an external administrator to take control of the company. Make sure that person is proficient and competent, and does not have any conflicts of interest.
- Generally, your options will be to appoint a voluntary administrator or a liquidator.
- It's important to understand that if you go into voluntary administration or liquidation you'll lose control of the company.
- Receivership generally occurs when a secured creditor appoints a receiver to try to recover money. Directors' powers will depend on the powers of the receiver.

Understand you'll still have obligations

- You'll need to assist the external administrator by providing books and other records.
- You may need to meet with the administrator, attend creditor meetings or be summoned to attend court.

Best practice and legal requirements

- Directors can be held liable for reckless trading, agreeing to a company incurring an obligation without reasonable grounds to believe the company can perform the obligation, and not exercising care, diligence and skill when exercising powers or performing duties (sections 135, 136 and 137 of the Companies Act 1993).
- Criminal cases that have been brought against directors by the FMA have included instances where directors failed to disclose to investors that their companies were unable to pay their debts when they fell due.

Find out more

The following websites and resources provide comprehensive information about topics related to the role of directors.

- The IoD ***website*** offers a wealth of information, as well as news of training, development and networking opportunities for directors at all stages of their careers. Directors of small and medium enterprises should review the section First Boards.
- ***The Four Pillars of Governance Best Practice*** (2018) is a comprehensive reference manual for New Zealand directors available from the IoD.
- The IoD ***Code of Practice for Directors*** provides guidance to directors to assist them in carrying out their duties and responsibilities with high professional standards. All IoD members sign up to the Code.
- The FMA ***website*** includes a section for ***directors and officers***.
- The FMA's 2018 ***Corporate Governance Handbook*** is a guide for directors, executives and advisers.
- The FMA's ***Going public, a director's guide*** helps directors and executives assess whether going public is appropriate for their company.
- The ***NZX Corporate Governance Code*** is a guide for corporate governance practices for NZX-listed companies.
- The Companies Office ***website*** contains easy-to-read information about registration and reporting requirements for companies.

Financial Markets Authority (FMA)

Auckland

Level 5, Ernst & Young Building
2 Takutai Square, Britomart

PO Box 106 672, Auckland 1143

Phone: +64 9 300 0400
Fax: +64 9 300 0499

Wellington

Level 2, 1 Grey Street, Wellington
PO Box 1179, Wellington 6140

Phone: +64 4 472 9830
Fax: +64 4 472 8076
Website: www.fma.govt.nz

Institute of Directors (IoD)

Wellington

Mezzanine Floor
50 Customhouse Quay, Wellington

PO Box 25253, Panama Street
Wellington 6146

Phone: +64 4 499 0076
Email: mail@iod.org.nz
Website: www.iod.org.nz