

A DIRECTOR'S GUIDE



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THE ESSENTIALS OF BEING AN EFFECTIVE DIRECTOR

Directors need to be both risk-managers and responsible risk-takers to enable companies to grow and survive. This guide will help you to identify risk management issues directors face.

Being a director is more than just a title. Directors are the representative of the company and shareholder, and answer to them. Even if you are also the main shareholder, as a director you'll have legal responsibilities to actively monitor the management of your company and may face serious penalties if things go wrong.

But the good news is, by keeping your feet on the ground, being alert to the risks and realities of what is happening around you, and by thinking for yourself, you will already be performing the most important duties and responsibilities of a director.

This guide outlines some of the essential behaviours directors should demonstrate to meet legal, regulatory and ethical standards for directors, and tells you where you can go to find out more.



BEFORE YOU TAKE UP A DIRECTORSHIP

- **Make sure you have the time**
 - You can only add value if you have the time your company needs to professionally carry out your duties.
 - In addition to the regular schedule of board meetings there may be spikes in activity as the board and management deal with particular issues. You will need to be able to accommodate irregular time demands.
- **Get to know the company and its markets**
 - How does it make money? How will it grow? How are risks being 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. Get some independent opinions.

“The responsibility for the governance of the company is theirs. They cannot simply treat the appointment as a sinecure and then leave to management, or other advisers, the duties of running the company and ensuring compliance with legal obligations. Let delinquent directors beware.”

Mason vs Lewis 2006 (Global Print Strategies)

- **Understand the responsibilities a directorship involves**
 - Ask the chairman and other directors what skills and focus the board is expecting you to bring. Can you do that?
 - You'll be in a governance not management role. Learn what the difference involves.
 - Become familiar with the legislation your company operates within. You may be personally responsible and liable for decisions made.
 - Ask about Directors and Officers Insurance and any prior or existing claims. Otherwise you may be personally liable.
 - Become familiar with Companies Act requirements such as preparing and filing annual reports and returns, as well as director responsibilities.

“Directors direct; managers manage. That is the essential difference between governance and management.”

The Queen v Moses, Doolan, Young, 2011 (Nathans Finance)

WHEN YOU ARE WORKING WITH OTHER BOARD MEMBERS AND MANAGEMENT

- **Remember the big picture**
 - What's the long-term strategy? How will what's happening internally and externally affect what you need to achieve? Check the details, but don't get caught up in them.
- **Do more than tick the boxes**
 - Make sure you comply with the law, but think, question and challenge too. Apply your skills and experience to help your company act honestly and with integrity.
- **Look for the bad news**
 - Even the best companies stumble sometimes. Check those regular reports management are giving you and keep an eye out for changes that might signal a problem. Follow-up and find out more. And don't wait until the board meeting to ask questions. Work with the Chief Executive and management to ensure the right information comes to the board.

“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.”

From landmark Australian court case ASIC vs Healey, June 2011 (Centro Finance)

- **Ensure the 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 and complicated issues facing the company. Minutes are signed off by directors as a true and accurate record of the meeting.
- **Learn from the annual review**
 - All boards should regularly review their performance, preferably annually. The review should be led by the chairman.
 - The review should assess skills – both peer and self-review is important as well as external input/advice.
 - Online appraisal tools such as the Institute of Directors' BetterBoards tool can help with the process.

HERE'S WHY: BEST PRACTICE AND LEGAL REQUIREMENTS

- Directors have a legal duty to "act in good faith and in the best interests of the company" (Section 131 of the Companies Act 1993).
- The New Zealand Principles for Corporate Governance include fostering high ethical standards and having a balance of independence, skills, knowledge, experience and perspectives among directors so the board works effectively.
- The Institute of Directors' Code of Practice notes that systematic review of the performance of individual directors (including the chairman) and of the board as a whole helps address weaknesses, increases skill levels and demonstrates a commitment to accountability.

WHEN YOU ARE 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.
 - Make sure you're familiar with the industry and the environment it operates in.
- **Ask questions**
 - Prepare by reading papers before the meetings.
 - Get advice, but test it too. Is the advice reasonable?
 - How does what your company is planning to do fit with its own policies, for example, key ones such as lending and credit policies and liquidity and provisioning.
- **Don't rely on the same people all the time**
 - Be alert to the risks of groupthink and think for yourself. You are required to exercise your independent objective judgment and not be railroaded by others.
 - Don't rely on others to make decisions for you.
 - Directors are able to seek their own advice independent of management and may wish to do so, on problematic or critical strategic decisions, but you still have to make up your own mind.
- **Be aware of possible conflicts of interest**
 - Make sure any conflicts you personally have are officially recorded. All companies should have an Interests Register and a process for managing potential conflicts.

- Where you have an 'interest' in a transaction, you need to be able to show how your company (or your parent company if your constitution allows this) benefits and gets fair value from it.
- Check if your company constitution allows related party transactions (transactions between related companies). 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 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.
- If you don't know, ask.

“The quality of any advice is only as good as the information provided to the professional, on the basis of which he or she is asked to advise. In considering the extent to which directors are entitled to rely on external advice, some assessment must be made of the prime information on which the adviser acted and whether he or she was on inquiry as to the accuracy of that information.”

The Queen v Moses, Doolan, Young, 2011 (Nathans Finance)

HERE'S WHY: 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 or have no knowledge such reliance is unwarranted (Section 138 of the Companies Act).
- The general requirement to act in good faith and best interests (Section 131) can apply to parent companies too, but only if permitted by their constitution (Section 131).
- Sections 139–149 of the Companies Act spell out the requirements for transactions involving self-interest and Section 4 defines the solvency test.



WHEN YOU SIGN OFF FINANCIAL STATEMENTS

- **Read them**

- Make sure you're familiar with how to read the key statements – the balance sheet, income statement (profit and loss) and cash flow.
- Check financial statements are consistent with other documents management has produced.
- Check the disclosures: What are the most significant areas of judgment? Are these reasonable and clearly disclosed?
 - Are there significant uncertainties about the on-going viability of the business that need to be disclosed?
- Do the maths, mistakes can creep in. It is not acceptable to be wise after the event.

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

- 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 – get them to explain if you're not sure. Remember auditors are only providing an independent opinion on the accounts – you're still responsible for signing the accounts as accurate.

“A director must understand the fundamentals of the business, monitor performance and review financial statements regularly. It follows that a degree of financial literacy is required....”

Davidson v Registrar of Companies, 2010 (Bridgecorp Group)

HERE'S WHY: BEST PRACTICE AND LEGAL REQUIREMENTS

- Directors have a legal duty to exercise their powers and duties with the care, diligence and skill that a reasonable director would exercise. This includes taking steps to ensure you are properly informed about the financial position of the company and ensuring you understand your responsibilities taken on behalf of the company (Sections 135–137 of the Companies Act 1993).
- New Zealand Corporate Governance principles include that boards should demand integrity both in financial reporting and in the timeliness and balance of disclosures on the company's affairs.
- The Guidance note: Disclosing non-GAAP financial information outlines the factors to consider if using non-standard financial reporting. This is available on www.fma.govt.nz

“Part 2 of the Act imposes obligations on those seeking investment from members of the public to provide them with adequate and accurate information prior to them making any commitment to invest, with a statutory prohibition on raising money unless the prescribed forms of disclosure have been complied with.”

R v Graham, February 2012 (Lombard Finance)

IF YOU ARE RAISING CAPITAL FROM THE PUBLIC

- **Learn the rules**
 - Various offer documents must be prepared.
 - Continuous disclosure obligations may also apply.
 - Make sure you have legal advice, but you'll also need to hold your own personal opinion that the documents comply with the law.
- **Make sure your investors get an accurate picture**
 - Put yourself in the place of your investors. Has the information you have provided (and the information you may have left out) provided them with a balanced view of the company? Could an investor make an informed decision on whether or not to invest?
 - Do your offer documents include all material information about the offer?

HERE'S WHY: BEST PRACTICE AND LEGAL REQUIREMENTS

- The Securities Act 1978 and Securities Regulations set out requirements for offer documentation.
- FMA monitors offer documentation to ensure it meets legal requirements. Where it doesn't, FMA has broad powers to cancel registration of a prospectus or prohibit allotment of securities or distribution of an investment statement.
- The **Guidance note: effective disclosure** outlines the factors to consider when developing offer documentation – available on www.fma.govt.nz

WHEN THINGS GO WRONG

- **Keep an eye out for warning signs**
 - Problems might range from conflicts within the board or with management through to severe and serious issues such as fraud or insolvency.
 - Monitor financial forecasts. Check underlying assumptions and consider whether they are realistic.
- **Find out who to go to**
 - Talk with your chairman and management including your Chief Financial Officer.
 - Get external advice from lawyers, auditors and other advisers. If the issue is serious don't rely on company advisers – get your own legal advice.
 - Alert the Financial Markets Authority if you feel investment offers are illegal or the securities laws have been breached. Contact the Serious Fraud Office if you suspect fraud.
 - Belong to a relevant membership organisation such as the Institute of Directors. 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.”

ASIC vs Healey, June 2011 (Centro Finance)

HERE'S WHY: BEST PRACTICE AND LEGAL REQUIREMENTS

- Directors have a duty under the Companies Act 1993 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). This is in addition to the general duty to act in good faith and in the best interests of the company.
- In addition, the first principle in New Zealand's Corporate Governance Principles is to observe and foster high ethical standards.



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 or 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 the board, not management makes the appointment. Make sure the insolvency expert is proficient and competent to advise and does not have any conflicts of interest.
 - Generally your options will be to appoint a voluntary administrator or 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 also need to meet with the administrator, attend creditor meetings or even be summoned to attend Court.

HERE'S WHY: BEST PRACTICE AND LEGAL REQUIREMENTS

- Directors can be held liable for reckless trading, incurring an obligation without reasonable grounds to believe the company can perform the obligation, and negligent trading [Sections 135, 136 and 137 of the Companies Act 1993].
- Criminal cases that have been brought against directors by FMA have included those where directors failed to disclose to investors that their companies were unable to pay their debts when they fell due.

“As at the date on which the investment statement and prospectus were distributed, the directors of Nathans knew there was no reasonable prospect that inter-company debts could be repaid without VTL selling all or some of its business units.”

The Queen v Moses, Doolan, Young, July 2011
(Nathans Finance)



TO SUM UP

Your essential duties and responsibilities as a director are to:

- be honest
- act with integrity
- act in the best interests of the company at all times
- have the right mix of skills and experience
- understand risk and be responsive to risks and conflicts
- ask the hard questions until you are satisfied you can make a decision.

FIND OUT MORE

The following websites and handbooks provide more comprehensive information about all these topics:

- **www.iod.org.nz** – The website of the Institute of Directors offers a wealth of information, as well as news of training and development, and networking opportunities for directors at all stages of their careers. Directors of small and medium enterprises should review the section First Boards, First Directors – a governance toolkit.
- The Four Pillars of Governance Best Practice (2012) – A comprehensive reference manual for New Zealand directors available from the Institute of Directors.
- **Corporate Governance in New Zealand – Principles and Guidelines** – A handbook for directors, executives and advisers. Available from **www.fma.govt.nz**
- **www.fma.govt.nz** – In particular see ‘How do I comply? – Issuers’
- **www.companies.govt.nz** – The website of the Companies Office. Contains easy to read information and links on registration and reporting requirements for companies.



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