Briefing

Joining a Board:
Due diligence for the company and the director

A board of directors’ key purpose is to ensure the company’s prosperity by collectively directing the company’s affairs, while meeting the interests of its shareholders and other relevant stakeholders. Every company should be headed by an effective board to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed.

It is best practice that the board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.

The company

From a company’s perspective there should be a formal, rigorous and transparent procedure for the appointment of new directors to the board. The search for the board candidates should be conducted and appointments made on merit against objective criteria and with due regard for the benefits of diversity on the board, including gender. For many companies this requires that there be a nomination committee (the majority of members being independent non-executive directors) to lead the process for board appointments and to make recommendations to the board. This briefing concentrates on the appointment of a non-executive director.

The company must ensure that the prospective director has the appropriate skill set required by the company and also that he or she will be able to allocate sufficient time to the company to discharge their responsibilities effectively.
Once a company identifies a suitable nonexecutive director and wishes to make an appointment, a letter of appointment should be put in place to cover the following matters:

- the role which the company wishes the director to play both in general and specific terms;
- the length of the term for which he or she is appointed;
- how a removal from appointment will be effected, including by reason of default by the director;
- the remuneration he or she will receive in his or her position as director;
- the requirement to comply with rules and regulations (if the company is in a regulated sector, fitness and probity rules may need to be complied with by the new director before an appointment can be made);
- the requirement to attend a minimum number of board meetings and more generally the likely time commitment;
- requirements as to confidentiality and non competition; and
- the obligation to undertake further training or refresher courses.

A properly drafted letter of appointment will provide both the prospective director and the appointing company with clear parameters within which each should operate so that the appointment will be successful with each party knowing exactly what is required of them. The company should also organise induction training for the new director (see below).

The new director

Before accepting an appointment as a director, it is important from a practical perspective that the prospective director undertakes a thorough examination of the company and how it conducts its affairs to ensure that he or she is entirely comfortable with how the company and its board operates and has determined that his or her skills, experience and own standards will fit well. The prospective director will want to ensure that, if appointed, he or she will not incur claims or liability as a director where the company is poorly run from a corporate governance viewpoint.

On 12 May 2011, the Chartered Governance Institute ("CGI") published an updated version of its Guidance Note, "Joining the right board: Due diligence for prospective directors" (available at www.icsa.org.uk). The Guidance Note is designed to advise a prospective director on the due diligence process he or she should undertake prior to joining a company.

The Guidance Note examines how a potential director should undertake due diligence. It states that the starting point should be the company’s annual report and its website. The company’s business model, how it is governed, its operational and financial performance, its market environment, recent company performances, company strategy, uncertainties, risks and financial performance should all be
examined. A review of all such corporate information will assist a prospective director in making an informed decision as to the current state of affairs of the company.

The Guidance Note recommends that before accepting a role, a prospective director should have pre-appointment meetings with the chairperson, CEO, CFO, company secretary and all members of the nomination committee, if not the entire board. It suggests that a prospective director should discuss with the board the outcome of the last board evaluation process and the plans to tackle any areas considered to be in need of development. It also states that it may be beneficial for a prospective director to meet some directors in pairs or in small groups as this can give an indication of the dynamics between board members.

If a prospective director is proposing to become chairperson or chair of the audit or remuneration committee, meetings should be set up in addition with the auditors, the head of internal audit or the remuneration advisers, as appropriate. The Guidance Note recommends that a prospective director should consider whether there are any other external advisers to the company whom he or she could usefully meet. A prospective director should also check scheduled board meetings for the year ahead early on in the due diligence process to ensure that he or she can attend most, if not all, of the planned meetings in the first year.

The Guidance Note also sets out a list of questions of the type a prospective director may want to consider before making a decision. The areas covered by these questions are as follows:

- the business;
- the company’s governance arrangements;
- the board (covering board composition, boardroom behaviour, operational matters and board evaluation);
- the role of the non-executive directors;
- remuneration;
- investor relations; and
- risk management.

CGI comment in the Guidance Note that some of the questions may be answered by reviewing available sources of information but that a prospective director should be aware that the company will be unable to disclose certain confidential or price sensitive information prior to his or her formal appointment (and induction training – see below) and should, if applicable, make himself or herself aware of and observe, the insider trading and market abuse laws and regulations in respect of insider information.

The new director, if accepting an appointment, should request that an appointment letter is put in place.
Before accepting an appointment, the prospective director should make enquiries regarding the induction training offered by the company. It is very important for a company as well as for a new director that induction training is provided as it will ensure that a new director is able to make a valuable contribution to the board at an early stage. Often the company secretary will provide the induction training and provide the new director with an induction package comprising relevant governance information for the company (including details on board duties and responsibilities, codes of conduct, calendar of meetings, contact information, company strategic plan, copy recent minutes etc).

A company director should also bear in mind that, except in limited circumstances, companies are not permitted to undertake to indemnify or exempt directors against any liability arising from negligence, default, breach of duty or breach of trust relating to the company. A company may however purchase and maintain insurance for directors and officers (“D&O”) against such liability. Often a director will maintain their own D&O policy. D&O policies operate on a claims made basis and not on an occurrence basis, so it is important to have cover in place when the claim is made (this might be after the director has ceased to be a director). Insurance cover should not be regarded as a substitute for a director conducting proper due diligence before his or her appointment or for complying with his or her obligations as a director during his or her appointment, being the legal obligations and the standards required by best practice corporate governance.

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