

The role and responsibilities of directors on board sub-committees¹

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SYNOPSIS

Public pressure for accountability and reform has seen its most powerful emanation in a new 'enthusiasm' for committees of the board stacked with independent directors as a snake oil like panacea for all that ails corporate Australia. This article examines the changing expectations for committees and suggests a number of practical measures that committee members can take to ensure they are satisfying their obligation and that boards should consider when establishing a committee.

INTRODUCTION

An examination of governance literature 10 years ago would have found only the vaguest references to committees and that would probably have been limited to a fairly cursory description of the possible use of an audit committee. Today the ASX corporate governance recommendations² contemplate a minimum of three committees,³ the annual report must disclose the number of meetings of each board committee and the audit committee's advice on fees and independence,⁴ the reliance defences contemplates reliance on a properly formed committee.⁵ Likewise, the OECD Guidelines⁶ on corporate governance had not previously acknowledged the existence of the committee in governance structures and are now resplendent with references to committees.⁷ Thus, the committee has become an important part of the organisational dynamic of the modern listed corporation.

The committee it is generally regarded as a more efficient mechanism than the full board for focussing the company on particular issues, but how does the committee structure fit within the context of collective responsibility for board members and what are the limits of that concept.

Are individual members of committees expected to have special responsibilities and exert special skills beyond those of the other directors, by reason of their position and possibly also by reason of his high qualifications, experience and expertise relative to the other directors.⁸ Do some committees by their nature assume a mandate to act in ways that, like the auditor, are more publicly oriented?

The increasing focus on the committee as the governance instrument responsible for the regulation of specific and difficult issues has probably practically if not legally brought with it increased liability for committee members.

WHAT IS A COMMITTEE?

The board is responsible for managing the company it is also responsible for monitoring performance and ensuring compliance and perhaps, more importantly reviewing or setting the company's strategic direction. Today's board has an important role in providing advice about the company's strategy, approving major investments, ensuring that major risks are identified and managed, to appoint the CEO and approve succession plans and senior management compensation.⁹ However, usually, a company's constitution permits delegation any of their powers to a committee of the board.¹⁰

The committee will generally be properly characterised as a sub-committee of the board.

A "committee" does not always mean more than one director; there can be an effective delegation to a committee of one.

Types of committees

Attached to this paper are some examples of the types of committees a large public company is likely to have, other committees might include an executive committee with power to act for the board between board meetings; a finance committee; a planning committee; a public affairs committee; and a superannuation committee. Additionally, there may be other committees set up for specific projects such handling a takeover bid or other major acquisition or a due diligence committee to conduct the inquiries necessary for a disclosure document. This demonstrates the widespread and growing use of committees. The committee is here to stay as a vehicle for corporate organisation.

Disadvantages of committees generally

While the use of committees may provide certain benefits, the drawbacks are also substantial and need to be considered. First, to the extent that the committee functions in the place of the full board, the corporation loses the benefit of the full range of business and leadership experience represented on the board. Second, determining membership on the various committees can present difficulties. How should the committee be constituted? Should it be entirely comprised of 'independents'? The other issue will be the nature of the committees' relationship with management, auditors, actuaries, lawyers and other external advisers to achieve the committee's objectives.

Third, the committee may incur additional expenses that may be significant the committee may believe it necessary to hire staff and external experts to participate with management and company counsel in the preparation of disclosures. In many cases, it may be inappropriate for internal advisers to advise the committee, both because person's loyalty will naturally lie with management and because they may be the very people the committee is supposed to be overseeing. Indeed, it will often be appropriate for the committee to be separately advised (see below).

The true danger in committees, however, is the threat of liability for the members of the committee. There is a very real possibility that committee members may find themselves subjected to a higher standard of care. Having been charged with oversight of specific matters and knowing that other directors are relying on the integrity of their work, the expected "reasonable investigation" is likely to be much more complete. The extent to which liability may be enhanced is difficult to predict. However, cases have indicated that the reasonableness of a director's investigation may well depend upon how active that director was and the level of the director's knowledge and experience. Considering the potential liability involved and the time and expense of defending unwarranted claims, even if indemnified or insured at company expense, this heightened standard is one which few directors may be willing to accept.

GENERAL OBLIGATIONS

The board's responsibilities go beyond strategic matters they have increasingly been required to undertake supervisory tasks to investigate and verify for themselves the effect of matters related to governance of the Corporation.¹¹

Directors have statutory and fiduciary duties to shareholders to act in good faith in the best interests of the company and for a proper purpose.¹² Individual directors and/or the individual members of the committees will be judged by this standard.

Delegation and its consequences

The *Corporations Act* recognises that the directors may delegate their powers to a variety of people¹³ including a committee of directors. Once delegated each director is responsible for the exercise of the power by the delegate as if the directors themselves had exercised the power unless the directors can establish that the committee was reliable and competent in relation to the power delegated.¹⁴

Under this approach, the delegating directors would make sure that the delegation of responsibilities to the committee is reasonable by ensuring that the members of the committee (either alone or with any professional advisers they may deem appropriate to use) are knowledgeable and capable of the envisaged role for the board. Delegating directors would also assure that the committee is provided the resources necessary to conduct a thorough investigation

and maintain appropriate oversight of the committee by periodically reviewing the committee's procedures.

The *Corporations Act* allows the directors to delegate their powers to a committee.¹⁵ Section 189 provides specific authority for the rest of the board to reasonably rely on information or advice provided to the board by a committee;¹⁶ however, the provision requires that the board make an independent assessment of the “advice, having regard to [their] knowledge of the corporation and the complexity of the structures and operations of the corporation”.¹⁷ The provision does not require the board to separately have the committee recommendations reviewed by, for example, an independent expert but it does require them to have listened to and assessed what is being proposed by the committee. They must bring their own mind to bear on the issue using such skill and judgment as they possess.¹⁸

The board should also ensure they adopt a written charter to govern the committee and establish the reasonableness of their reliance on the information coming to the board from the committee.¹⁹ If the directors have taken these steps then they will usually have established that they have satisfied their statutory and common law duties irrespective of a failure by the committee in some respect.

Adopting the charter alone is not sufficient; there should be an annual assessment by the committee of the adequacy of the charter. The committee (and the board of directors as a whole) should carefully review and, if necessary, update their committee's charter to ensure that it not only meets the applicable requirements but also properly addresses the role the committee will in fact play in process. Committees should consider what, if anything, different from the past they will do. In addition, the committee should assure itself that in the course of its activities it in fact addresses the matters the charter contemplates that it will address.

Composition

A committee need not be comprised solely of directors, it might include management or external advisers although it might mean that non-directors are taken to be directors by virtue of the shadow director provisions ie are they becoming a person with whose instructions or wishes the directors are accustomed to act.²⁰

Over and above the issues of independence and similar thwart seem to fill the literature of governance, if the board is hoping to effectively rely on the work of its committees it should consider committee members past and current work and educational experience qualifications.

Duty to monitor

The directors of a company have a duty to monitor the company and its employee's failure to do so could amount to a breach of duty to act with the requisite level of care and diligence and with good faith for the purpose of the business judgement rule. The directors must monitor the committee's activities, they cannot simply 'hand off' responsibility.

COMMITTEE MEMBERS OBLIGATIONS

Australian courts have not separately reviewed the role of a committee as distinct from the director's role as a board member. Further there is some doubt about whether the kind of distinctions drawn by Rogers CJ in *AWA Ltd v Daniels*²¹ regarding executive and non-executive directors can be sustained. To be liable under s 181 the committee member would need to be shown not to have acted with “the degree of care and diligence that a reasonable person would exercise if they occupied” the position of a committee member and to not be entitled to the protection of the business judgement rule.

US authorities

While the case law in the United States is sparse, United States courts have found that audit committee members have an obligation “to question the information being presented to them”.²² The general theme of the United States cases is that committee members are “inside directors” and

as such have a heightened exposure to liability, which is they have a higher monitoring obligation than non-audit committee members and other non-executive directors.²³

In the US a few courts have held outside directors primarily liable for misrepresentations made in publicly-filed documents which they had signed despite the fact that they had played no role in the preparation of the challenged documents. *In re JWP Inc Securities Litigation*,²⁴ officers and directors were sued for disclosure violations when JWP was forced to restate its audited consolidated financial statements due to numerous accounting irregularities which were discovered by JWP's new president.

The write-offs reflected on the restated financial statements were extensive and wiped out JWP's entire net worth, forcing the company into bankruptcy. The court determined that directors who had served on JWP's audit committee, and who had signed the corporation's Annual Form 10-Ks, had "actually made" the misrepresentations contained in those filings. Although these outside directors had not played a role in the day-to-day operations of the company, they nevertheless had been repeatedly informed by the company's auditors that the internal auditing procedures were an "area of concern which needed to be improved." This was ample evidence, the court held, for a reasonable jury to conclude that the defendants had "acted with sufficient recklessness . . . [to] infer fraudulent intent."²⁵

In re Hayes Lemmerz International, Inc. Equity Securities Litigation, the Court's allowed the action to proceed based upon relatively general allegations about the now established responsibilities of the audit committee members. The court cited language about audit committee responsibilities found in the audit committee charter, the financial statements, and new statutes, the Court held that in an action for alleged accounting error or restatement the plaintiffs sufficiently alleged that the audit committee was responsible for oversight of management's accounting, financial statements and internal controls to deny dismissal of the controlling person claims against the audit committee members.

Thus in the US the committee members due to their specific functions and new more explicit responsibilities, now have increased liability exposure, and it is all the more important that the committee undertake its activities, and documentation, to evidence appropriate good faith, diligence and business judgment.

Australian position

In Australia after the *AWA Appeal*²⁶ the position is not clear regarding the level of duty imposed on executive and non-executive directors and axiomatically between committee members and other directors. The better view is probably that the standard of reasonableness expected of directors varies depending on the level of understanding of the relevant director and their role, for example as a committee member.²⁷

An Australian court is likely to assess whether the committee members have satisfied their statutory and common law obligations to act with a reasonable degree of care and diligence by reference to industry practice. As was demonstrated in *Greaves Case*²⁸ the Court is likely to have regard to peer expectations in assessing what might be expected from a committee member. In this context community expectations will no doubt be fanned by the ASX Corporate Governance Council's *Principles of Good Corporate Governance and Best Practice Recommendations* these proposed guidelines (despite being based on a "if not why not" model) and material like the Australian Standard on Corporate Governance will form part of the new standards against which a chairman committee member is likely to be judged.

Reliance

Like other directors committee members are entitled to rely upon other people in the performance of his or her activities as a committee member. That is, for example, the audit committee member does not personally complete transactions or maintain accounting records, but rather receives requested reports and information. Reliance on a report or other information provided by another person is reasonable, but only if that other person is sufficiently informed and qualified to provide the report or information.²⁹

Independent advice

The committee should have particular regard to whether they ought to have the advantage of advice from independent advisers (not otherwise employed by the company).³⁰ Committee members will often benefit from advice from independent and experienced advisers who appreciate what is involved and can advise the committee. Sometimes the monitoring role of the committee will mean this advice should be completely independent of any affiliation with management, and separate advisers should be retained to independently advise the committee. The advisers should be providing the committee with written advice.

In this context “independent” refers to the restrictions on relationships between the advisers providing the advice and management and/or third parties that might affect the adviser’s capacity to provide zealous representation and advice to the audit committee and should be determined in a way that is consistent with the committee’s approach to audit independence.

In the US the SEC’s view is that use of truly independent counsel is also a factor looked upon favourably by the courts and may help to shield independent directors who are members of the audit committee.³¹ Independent advice, particularly in related party transactions is a powerful tool that can benefit the committee by assisting them in marshalling arguments to balance those presented by management in matters involving actual or apparent conflicts of interest. Independent counsel will also assist the committee to evaluate issues with an independent and critical eye; eg. on the key assumptions.

In the Hollinger investigation in several places the Report³² is critical of the audit committee for failing to seek any advice from independent financial or legal experts and more generally:

More generally, the Audit Committee failed to monitor effectively Hollinger’s compliance with its disclosure requirements under the federal securities laws, or to detect the recurring pattern of violations of fiduciary duties committed by Black, Radler and their cohorts. Plainly the Audit Committee did not do enough, and its inert behaviour contributed to these events...

On balance, however, the Audit Committee’s ineffectiveness is primarily a consequence of its inexplicable and nearly complete lack of initiative, diligence or independent thought. The Audit Committee simply did not make the effort to put itself in a sufficient position to recognize untruthful or misleading information, or even to make informed decisions on the issues before it. Black and Radler knew that the Audit Committee was relying exclusively on the information that they fed to the Committee and they took advantage of the easy opportunity for self-dealing that these circumstances provided.

Relationship to the board

Lastly, it’s worth remembering that the committee is a subcommittee of the board. It would be unusual for any committee to act independently of the board. In other words, the committee should present issues on which the board will vote. However, the increasing complexities of dealing with committee materials will likely cause the overall board to place greater reliance upon the committee with respect to technical and oversight issues. From the committee perspective, it is important that there is an understanding with the board about what the committee responsibilities will be. The committee does not want its actual or implied responsibilities to be too broad, or for there to be a misunderstanding about what those duties are for this reason it is imperative that each committee have a charter that clearly sets these matters out and limits unreasonable expectations.

So, where does this lead us? A governance framework, including committees appropriate expertise, compliance processes, active diligence, and assistance from legal counsel, auditors and other professionals, leads to better decision making and manages risk.

BUSINESS JUDGMENT RULE

Under the statutory business judgment rule the court will only review a committee’s decision, for rationality³³ provided the prerequisites for the business judgement rule are satisfied.³⁴

In the present context probably the most important prerequisite for the application of the business judgment rule is that the committee members have informed “themselves about the subject matter of the judgment to the extent they reasonably believe appropriate”,³⁵ that is, the committee came to an informed decision. The committee members need to be able to establish they conducted

themselves in a manner that would likely enable them to reach an informed business judgement. The committee needs initiative, diligence and independent thought it needs to be able to put itself in a position to recognise untruthful or misleading information.³⁶

Good faith

*In re Lernout & Hauspie Securities Litigation*³⁷ revolved around the audit committee's failure to deal with certain matters raised by the external auditor, which had made recommendations about internal controls concerning revenue recognition, cash collections and outstanding receivables. The court held that for purpose of the motion to dismiss, there was sufficient evidence to deny the motion because the audit committee members had signed the company's SEC filings; the audit committee had the ability to retain accounting and legal advisers to investigate the accounting improprieties alleged.

The court considered that the audit committee had been put on notice that problems existed, but had done nothing to investigate them, nor had it received specific assurances from either the auditor or management that the problems were being resolved. The directors' failure to act against the evidence of systemic failure was a breach of the directors' duty of good faith, and as a result the directors were not able to avail themselves of the business judgment rule, which is a "safe harbour" for directors. The court decision also contains an interesting discussion about control person liability, indicating an increasing trend to hold audit committee members responsible for company financial securities liability because audit committee members have the authority to directly or indirectly control the senior officers of the company.

It is possible that the absence of an investigation in similar circumstances could be extended in Australia to situations where committees are not expressly warned of illegality - but conduct a superficial review of the material before them in circumstances where a proper review would have uncovered illegality and avoided risk.

The good faith obligation would seem to include an obligation to penetrate beyond the superficial whilst this is a more onerous obligation than that held by a director generally because a specific responsibility has been assigned to the committee it is consistent with the obligation to exercise a level of care and diligence having regard to the circumstances of the director the office held.³⁸

This is consistent with *Greaves Case*³⁹ a case arising out of the collapse of One.Tel. The court took into account the roles held by John Greaves as chair of the One.Tel board and chair of the audit committee, when assessing the scope of the legal duties that Greaves owed to One.Tel. This is the first sign of a willingness of Australian courts to adopt the type of reasoning US courts have used in respect of directors on audit committees.

Avoiding conflicts of interest

If committee members wish to avail themselves of the business judgment rule they will need to be continuously vigilant to identify circumstances of conflicting interests, that is, circumstances where they have a material personal interest in the matter before the committee.⁴⁰ In *ASIC v Adler*⁴¹ Santo J held that Mr Adler and Mr Williams each as major shareholders in HIH had "a material personal interest precluding the application of the business judgment rule".

IMPLICATIONS FOR INSURANCES

Even though the business judgment rule provides some statutory protection for directors, the reality is that there will be no shortage of proceedings against directors (and audit committee members in particular) in the years to come. Qualified individuals could reasonably be more expected to be reluctant to agree to sit on some committees. If they do sit on them they will want the highest possible level of protection from claims against them using both indemnities in the constitution and comprehensive directors and officers liability insurance.

Practically, indemnities in the constitution are subject to strict limitations as to the matters for which a company can indemnify a director; these are essentially limited to legal costs in defending proceedings and claims by third parties.⁴² The most practical solution for protecting against liability is through directors and officers (D&O) insurance.

There are restrictions on the breadth of the cover that may be provided⁴³ but these have no particular application to audit committee members and would not adversely impact the kinds of D&O insurance usually carried by public companies to cover directors in respect of liabilities incurred by them in the course of carrying out their duties as directors and, in particular, as audit committee members.

Committee members ought to carefully review the D&O policy exclusions and consider how these exemptions might limit the cover provided, that is, the insured versus insured, professional indemnity and prospectus types of exclusions. In each case the committee should address their mind to the policy terms and in particular the level of cover provided. Plaintiffs, meanwhile, are seeking larger damages than ever. Until now, the largest settlement of a United States shareholder suit was \$3.2 billion. That amount will be dwarfed by the Enron case, even if the litigation is ultimately settled for a fraction of the \$60 billion in market value shareholders lost. Enron's \$350 million D&O policy, purchased from eight different carriers, will almost certainly be exhausted. That means former directors may face devastating claims against their personal assets – and that is if Enron's D&O insurers pay at all. If the company misrepresented its financial condition when it bought the policy, the insurance companies may refuse to pay the claim.

CONCLUSION

As the body of material concerning governance and governance standards grows, so does the level of responsibility and liability of committee members. A committee member it must be conscious of the additional responsibilities that flow from membership of a committee of the board. These responsibilities are likely to be applied to membership of all kinds of committees including audit, safety and remuneration to name a few that might turn 'hot'.

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ATTACHMENT

TYPICAL COMMITTEES IN AUSTRALIAN PUBLIC COMPANIES

Disclosure committee

The role of the disclosure committee is to ensure compliance with the corporations' obligation to make timely and balanced disclosure. To supervise and implement the continuous disclosure regime to ensure that matters that a person could reasonably expect to have a material effect on the share price. The disclosure committee often takes primary responsibility on behalf of the board for conducting periodic reviews into the corporation's public disclosures.

The committee can be more involved in the ongoing disclosure process. This helps avoid situations where time pressures are building and the board is presented with a disclosure document that is, for all intents and purposes, a fait accompli. The disclosure committee can also be composed of those directors who are most knowledgeable concerning financial and disclosure issues.

A disclosure committee would almost certainly provide benefits to those directors not serving on the committee. The committee, with the help of its advisers, should be able to sift out the routine disclosure issues and bring only the more pressing ones to the attention of the full board of directors.

Even more important, however, after the introduction of enhanced disclosure rules in the Corporations Act⁴⁴ the existence and functioning of the disclosure committee would help insulate the non-disclosure committee directors from liability by performing for the delegating directors an investigation into the accuracy of the disclosures. The due diligence defence⁴⁵ requires a director to conduct a reasonable investigation. By delegating this duty to a disclosure committee, a delegating director could assure a more thorough investigation than any individual director could complete.

Related party committee

There may be a separate committee to review transactions with substantial shareholders or similar.⁴⁶ The purpose of this committee is to provide a forum for the review of transactions between the corporation and its related parties. In particular, to review agreements/business transactions with related parties, ensuring that they:

- occurred within a normal business relationship, and
- were on terms which were no more favourable than would reasonably be expected of transactions negotiated on an arms-length basis.

Health, Safety and Environmental Committee

This committee would be established to advise the boards in relation to health, safety, and environmental matters arising out of the activities of the corporation as they affect employees, contractors, visitors and communities.

In order to undertake its activities the committee would usually be responsible for one or more of:

- recommending, changes to policy;
- monitoring compliance;
- assessing standards for minimising risks;
- assessing the compliance with legislation;
- considering issues that may have strategic, business and reputational implications for the corporation and recommend appropriate measures and responses; and

- reviewing significant incident investigation reports.

Corporate Governance Committee

These committees are usually responsible for general oversight of corporate governance. The responsibilities of a corporate governance committee usually include some combination of responsibility for:

- alignment of the board's operations with best corporate governance practice;
- review of the effectiveness of committees;
- overseeing the process for review of the board, the CEO and the chair;
- approving corporate governance statements of the corporation;
- determining the independence of the directors and monitor the ongoing status of those directors; and
- reviewing existing behaviour and ethical guidelines for directors and considering questions of possible conflicts of interest.

Nomination committee⁴⁷

These committees review and consider the structure and balance of the board and make recommendations regarding appointments, retirements and terms of office. In particular, the committee will usually include responsibility to:

- identify and recommend to the board, candidates for the board and competencies of new directors;
- review induction procedures;
- assess and consider the time required to fulfil their duty;
- review succession plans for the board;
- review measures for keeping directors up to date with the corporation's activities and external developments.

Remuneration committee

The committee is usually expressed to be "responsible for ensuring that the corporation has coherent remuneration policies and practices which are consistent with human resources objectives and which enable the corporation to attract and retain executives and directors who will create value". It's this committee that will assume responsibility to "equitably, consistently and responsibly reward executives having regard to the performance of the corporation, the performance of the executive and the general pay environment." In the context of the Corporations Act needs to take control of the disclosure obligations relating to executive remuneration⁴⁸ and the adoption of the remuneration report.⁴⁹

The committee's usual responsibilities would include:

- review the company's approach to compensation;
- oversight of the establishment of compensation proposals;
- consider of all material remuneration decisions eg the CEO, CFO etc;
- recommendations as to appropriate incentive schemes.

Audit committee

Virtually all sets of corporate governance guidelines recommend (or require) that boards of large and/or publicly listed companies should have (at least) an audit committee. Post HIH, Enron etc there have been substantial materials produced about what an audit committee should do and how it should be comprised. Generally the committee oversees:

- the adequacy of the corporation's accounting system and internal control environment;
- the adequacy of the corporation's system for compliance with relevant laws, regulations, standards and codes;
- the effectiveness of their internal accounting controls;
- the identification of improvements that can or should be made to the corporation's internal controls, policies and financial disclosures;
- that the internal auditor has an unobstructed and clear communication channel to the committee;
- the frequency and significance of all transactions with related parties and assesses their propriety;
- the integrity and quality of the [the corporation's financial information including financial information provided to ASIC, ASX and shareholders; and
- the independence, objectivity, scope and quality of the external audit.⁵⁰

The committee will generally also assume responsibility for disclosure of details of amounts paid for non-audit services and a general statement as to the independence of the auditor.⁵¹

¹ This paper is based on presentations made for the University of Melbourne Centre for Corporate Law and Securities Regulation "Directors' Duties: Recent Developments and Their Implications for Directors and Advisors" August 4 2004 Melbourne and August 11 2004 Sydney.

² ASX Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations* available at <http://www.shareholder.com/visitors/dynamicdoc/document.cfm?documentid=364&companyid=ASX>

³ Recommendation 2.4 – nomination, 4.2 – audit, 7.1 – risk oversight and 9.2 – remuneration.

⁴ s 300 (10)(c), 300(11D)

⁵ Section 189(a)(iv)

⁶ OECD Principles of Corporate Governance: 2004 The governments of the 30 OECD countries have approved a revised version of the OECD's Principles of Corporate Governance adding new recommendations for good practice in corporate behaviour with a view to rebuilding and maintaining public trust in companies and stock markets available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf>

⁷ According to the *22nd Study of Boards of Directors in Australia* (Korn/Ferry International, 2003) which is a study of 494 listed Australian companies: 90% of the companies studied have an audit committee (100% for the largest 50 companies) and 64% have a remuneration committee (90% for the largest 50 companies). Use of other board committees is much less. For example, only 6% have a risk committee (16% for the largest 50 companies).

⁸ See A Lumsden, "A Chairman's lot is not a happy one" [2003] *BCLB* [73].and ASIC Media Release http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/03-068+Landmark+decision+on+chairman's+duties?openDocument discussing *ASIC v Rich*

⁹ <http://www.lawlink.nsw.gov.au/scjudgments/2003nswsc.nsf/66950614059df523ca25673900081e8e/e9e96caa4e2eda76ca256cd60080e7d6?OpenDocument>

⁹ While governance and compliance is always important the importance of actually running a company should never be forgotten, there is always a role for activist boards and aggressive governance. The board needs to be a lot more than a conclave of cronies willing to rubberstamp management decisions. It needs to be an informed group of independent thinkers who immerse themselves in the company's affairs and play a key part in crafting strategy.

¹⁰ Section 198D (1)(a).

¹¹ For example, ss 295(4) and 303(4) of the *Corporations Act* concerning directors' declarations for full and half-year financial reports and s 344 regarding ensuring that the company complies with its obligations to keep proper accounting records and complying with the annual and half-yearly reporting requirements. *Corporations Act*, s 319 requires public companies to prepare and lodge financial statements with ASIC that have been audited in accordance with AuASB Auditing Standards promulgated by the Australian Auditing and Assurance Standards Board (AuASB) of the Australian Accounting Research Foundation. The

financial statements are the responsibility of the company's management; the auditor is responsible for expressing an opinion on those statements. Auditors constitute the principal external check on the integrity of financial statements.

¹² Section 181(1) of the *Corporations Act* which differs from the former s 232(2), in that it codifies common law principles that impose duties on directors and other officers to act in good faith in the interests of the company and for a proper purpose: see Ford, Ramsay and Austin, *Ford's Principles of Corporations Law* (2000) at [8.065].

¹³ Section 198D.

¹⁴ Section 190.

¹⁵ Section 198D and see Ford, Ramsay and Austin, n 19, at [7.264]; see also s 3.2 of Appendix D to the Ramsay Report.

¹⁶ Section 189(a)(ii).

¹⁷ Section 189(b)(ii).

¹⁸ *Southern Resources Ltd v Residues Treatment & Trading Co Ltd* (1990) 3 ACSR 207 at 225.

¹⁹ Note that the *Corporations Act* s 251A requires that delegations of the kind frequently given to the audit committee must be recorded in the company's minute book.

²⁰ Section 9 definition of 'director'.

²¹ (1992) 9 ACSR 383

²² *Tischler v Baltimore Bancorp* 801 F Supp 1493; 1992 US Dist LEXIS 10102; Fed Sec L Rep (CCH) P97, 429 (1992) citing Braiotta Jr L, "Preventing Fraudulent Reporting; Auditing for Honesty" (1992) (May) *American Bar Association Journal* 76 at 79.

²³ *Dixon v Deacon Morgan McEwen Easson* ACWSJ LEXIS 41866; 1989 ACWSJ 554356; 18 ACWS (3d) 588 (1989). See also Lurato K, "The Problems with Applying a Heightened Standard of Care to the Corporate Audit Committee" (2001) 30 *Stetson Law Review* 977.

²⁴ 928 FSupp. 1239, 1255-56 (S.D.N.Y. 1996)

²⁵ See also *F.N. Wolf & Co., Inc. v. Estate of James W. Neal*, 1991 WL 34186 (S.D.N.Y.) ("[D]irector signing a document filed with the SEC . . . 'make[s] or causes to be made' the statements contained therein") see *In re Cabletron Systems, Inc.* (1st. Cir. 2002) 311 F.3d 11; and *Howard v. Everex Sys., Inc.* (9th. Cir. 2000) 228 F.3d 1057.

²⁶ *Daniels v AWA* (1995) 16 ACSR 607 (

²⁷ *Duke Group Ltd (in liq) v Pilmer* (1998) 27 ACSR 1.

²⁸ ASIC v Rich 44 ACSR 341

²⁹ Section 189 (b).

³⁰ For example in the US Final Rule: Role of Independent Directors of Investment Companies SEC 17 CFR Parts 239, 240, 270 and 274 (Release Nos 33-7932; 34-43786; IC-24816; File No S7-23-99) available at <http://www.sec.gov/rules/final/34-43786.htm> regarding when directors address questions of the appropriateness and legality of proposed transactions between mutual funds and their promoter, adviser, or principal underwriter (or any other affiliated person).

³¹ Speech by SEC staff. "Awarding Complacency, Advocating Reform: The Commission's Independent Fund Directors Initiative." Paul Royce, 1999 WL 985310 (SEC) available at <http://www.sec.gov/news/speech/speecharchive/1999/spch314.htm>.

³² Report Of Investigation By The Special Committee Of The Board Of Directors Of Hollinger International Inc. Gordon A. Paris, Chairman, Graham W. Savage, Raymond G.H. Seitz, Counsel and Advisors Richard C. Breeden & Co., The Law Offices of Richard C. Breeden Counsel O'Melveny & Myers LLP - August 30, 2004 available at <http://www.sec.gov/Archives/edgar/data/868512/000095012304010413/y01437exv99w2.htm> see pg 500 and 493.

³³ Section 181(2) of the *Corporations Act* requires that the committee need only rationally believe that the decision is in the best interests of the company, ie that the decision was one that no reasonable person in their position would hold provided the prerequisites are satisfied.

³⁴ Section 180(2).

³⁵ Section 180(2)(c).

³⁶ For an interesting example of where this didn't occur see Report Of Investigation By The Special Committee Of The Board Of Directors Of Hollinger International Inc. Gordon A. Paris, Chairman, Graham W. Savage, Raymond G.H. Seitz, Counsel and Advisors Richard C. Breeden & Co., The Law Offices of Richard C. Breeden Counsel O'Melveny & Myers LLP - August 30, 2004 available at <http://www.sec.gov/Archives/edgar/data/868512/000095012304010413/y01437exv99w2.htm> see pg 493-507.

³⁷ U.S.D.C. Mass. November 18, 2002

³⁸ Section 180(1)(b).

³⁹ ASIC v Rich 44 ACSR 341 and A Lumsden, "A Chairman's lot is not a happy one" [2003] *BCLB* [73].

⁴⁰ Section 180(2)(b).

⁴¹ [2002] NSWSC 171.

⁴² Section 199A(2) of the *Corporations Act* prescribes the types of indemnity a company and its related bodies corporate can grant an officer or auditor. A company may not indemnify its directors against liabilities they may incur, in their capacity as directors toward the company itself or a related body corporate, but may indemnify them against liabilities, incurred in good faith, to other parties: see generally, Kyrou E, "Directors' Duties, Defences, Indemnities, Access to Board Papers and D & O Insurance Post CLERPA" (2000) 18 *C&SLJ* 555.

⁴³ Section 199B.

⁴⁴ Chapter 6CA.

⁴⁵ Section 674(2B).

⁴⁶ A good example of best practice in this area is Coca Cola Amatil who describe their related party committee as: "Related Party Committee – The Related Party Committee provides a forum for the review of transactions between the Company and its related parties. Membership of the Related Party Committee is comprised of Non-Executive Directors and does not include any Directors who are or have been associated with a related party. The Committee meets prior to each scheduled Board meeting. It reviews all material transactions of the Company to which The Coca-Cola Company is a party to ensure that the terms of such transactions are no more favourable than would reasonably be expected of transactions negotiated on an arm's-length basis." Available at http://www.cccamatil.com/images/uploads/annual/2001/Board_Corporate_Governance.pdf

⁴⁷ ASX Recommendation 2.4

⁴⁸ Section 300A.

⁴⁹ Sections 250R and 250SA contain detailed provisions regarding the process for putting the remuneration report to members.

⁵⁰ Committee members should understand the importance of the auditor remaining independent. Committee members should be familiar with the rules Part 2M.4 of the *Corporations Act* concerning who can and cannot be an auditor, Australian rules on auditor independence contained in The AuASB's Auditing Standard AUS 1, and Statement of Auditing Practice AUP 32 "Audit Independence"; and the two main professional bodies' Code of Professional Conduct.

⁵¹ Section 300(11B) and (11C)