

Non-Executive Directors

Their role and responsibilities in a private company

THE
INSTITUTE OF
CHARTERED
ACCOUNTANTS
OF SCOTLAND



A Practical Guide from The Institute of Chartered Accountants of Scotland.

**NON-EXECUTIVE DIRECTORS:
THEIR ROLE AND RESPONSIBILITIES
IN A PRIVATE COMPANY**

A Practical Guide
from
The Institute of Chartered Accountants of Scotland

PUBLISHED IN MAY 2009
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SCOTLAND

© 2009
ISBN 978-1-904574-52-1
EAN 9781904574521

This document is published by the Technical Policy Board of The Institute of Chartered Accountants of Scotland. The views expressed in this publication are those of the Business Policy Committee and do not necessarily represent the views of the Council of The Institute.

This document gives general guidance only and should not be relied on as appropriate or comprehensive in respect of any particular set of circumstances. It is recommended that users consider taking specific advice from their own professional adviser.

No responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication can be accepted by the authors or the publisher.

All rights reserved. This publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, with appropriate acknowledgement of the publisher.

This booklet can be downloaded without charge from the Institute's website at:
www.icas.org.uk/non-exec

A hard copy can be obtained on request from:
The Institute of Chartered Accountants of Scotland
21 Haymarket Yards, Edinburgh EH12 5BH
Tel: 0131 347 0240
Fax: 0131 347 0114
E-mail: accountingandauditing@icas.org.uk

The members of the Institute's Business Policy Committee who took part in this initiative were:

Lorraine Bennett
KPMG LLP

Martin Cowie
PricewaterhouseCoopers LLP

Chris Fletcher
Baillie Gifford & Co

Kenneth Gilmour (Convener)
Standard Life plc

Paul Hally
Shepherd and Wedderburn LLP

Julian Lamont
The Buccleuch Group

Mike McGill
Murray International Holdings Ltd

Robin McGregor
Christie Griffith Corporate Ltd

John Moffat
Grant Thornton UK LLP

Robert Pattullo
Archangel Informal Investment Ltd

Becky Woodhouse
PURE Spa

Charlotte Barbour (Secretary)
The Institute of Chartered Accountants of Scotland

It should be noted that the members of the Committee were acting in their personal capacity and were not representing the organisations for which they work.

**NON-EXECUTIVE DIRECTORS:
THEIR ROLE AND RESPONSIBILITIES
IN A PRIVATE COMPANY**

Contents	Page
Foreword	1
Introduction	3
1 What should a company expect from a non-executive director?	4
2 What should a non-executive director expect from a company?	7
3 Managing the potential risks of being a non-executive director	9
4 Duties and responsibilities of a director	11
Appendices	14
Appendix A – non-executive director’s appointment letter	14
Appendix B – other sources of useful information	14

NON-EXECUTIVE DIRECTORS: THEIR ROLE AND RESPONSIBILITIES IN A PRIVATE COMPANY

FOREWORD

by

Sir Tom Farmer CVO, CBE, KCSG, DL

A successful non-executive director manages a difficult balancing act but the position can be very fulfilling. Accepting a position as a non-executive director should bring rewards to both the non-executive director and the company. It also brings risks and responsibilities, which both parties need to be aware of and manage.

The non-executive's role is to participate fully in the functioning of the board, advising, supporting and asking the right questions of management. It is a challenging position which requires knowledge, confidence, analytical skills and an external, objective viewpoint in order to assist the company's board. A great deal can be expected from a non-executive director.

This guide is designed to be practical and to assist boards in deciding whether they wish to appoint a non-executive director and what should be expected from that appointment. It should also assist non-executive directors in fulfilling their role on a company board and it can be used by someone who is asked to become a non-executive director, to help him or her in evaluating whether or not to accept the position.

I am pleased to support this publication, which is a companion document to 'Avoiding the Pitfalls in Running a Private Company'. Both publications reinforce the reputation of The Institute of Chartered Accountants of Scotland as a provider of useful guidance to its members and to the wider business community.

May 2009

Introduction

The appointment of a non-executive director should be the result of a two way process involving careful consideration of what each party wants out of the appointment.

When a company reaches a certain stage in its evolution, the appointment of one or more non-executive directors is often proposed. Such a proposal needs to be carefully evaluated to decide if it would add value, what would be expected of the non-executive director, what the company can offer the candidate and who to appoint. A non-executive director on the board of a private company can be very beneficial; however, this is not always the case and it may be an unfulfilling and expensive decision if the role has not been carefully analysed, defined, and communicated beforehand, and the best individual appointed to the position.

A non-executive director is expected to bring his or her experience and an external viewpoint in order to assist and, where necessary, challenge the board of a company, making sure that board decisions are balanced and not dominated by a single, or small group of, executive directors. The non-executive director is expected to be independent of mind and rigorous in his or her analysis. Non-executive directors are not involved in the management of the company on a daily basis, nor in the internal running of the company. However, the board, which includes executive and non-executive directors, is collectively responsible for the success or failure of the company. As a result they must fully understand how the company operates and how risks are managed.

An individual may already have one or two non-executive appointments and wish to add to this, or to extend his or her experience beyond an executive post. Working with a company may broaden and enrich the non-executive director's experience. It also associates that person with the company and the board, brings the same liability as for the executive directors and so carries risks for the individual to his or her reputation and, potentially, legal and financial risks.

This guide is designed to help identify:

- whether a company would benefit from appointing non-executive directors
- the expectations that a board and its shareholders may have of a non-executive director
- the support and information that may be expected from the company management so that the non-executive director can fulfil his or her remit
- the duties and responsibilities of individual directors
- potential risks to each director.

It also outlines a number of practical measures, which should help both the company and the directors to fulfil their roles and to manage their risks effectively.

This guide is for:

- private companies and shareholders who wish to know what is expected of a non-executive director
- individuals who are asked to join a private company as a non-executive director to help them assess whether they wish to accept the position
- non-executive directors of a private company who wish to evaluate their position.

This guide is not intended to be prescriptive but simply to suggest points that a non-executive director and a company board may wish to consider in order to manage expectations, and to manage potential risks.

ICAS is pleased to publish this guide for the use of non-executive directors and boards of private companies. It is published as a companion document to '**Avoiding the Pitfalls in Running a Private Company**', which contains guidance on the principles of good governance, focusing on the relationships between board members and the collective responsibility of leading the company.

1 What should a company expect from a non-executive director?

Before deciding to appoint non-executive directors the board should consider carefully whether this would be beneficial. The Combined Code on Corporate Governance for listed companies contains the principle that the board should include a balance of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision making.

This principle is filtering down to the private sector and, also, frequently, lenders or external investors will want a non-executive director on the board to bring an external perspective to represent their interests. A non-executive director can bring additional skills and expertise to a board, but this is more likely to be mutually beneficial, to the company and the non-executive director, if the appointment has been carefully thought through beforehand via an open and constructive recruitment process.

Why consider appointing non-executive directors?

There are a number of reasons why a private company may decide to bring a non-executive director on to the board of directors, including:

- a company may wish to utilise the knowledge, skills and reputation of an expert within the industry and access his or her contacts as a means of reaching new business opportunities or capital, whilst managing carefully any conflicts of interest which arise
- a company may be too small to employ, or afford to employ, full time executive directors and therefore the appointment of a non-executive director can widen and compliment the board's experience and skill-set in a relatively cost effective manner
- for a young start-up company an experienced non-executive director may bring objective challenge and strategic advice without becoming too involved in the day-to-day running of the business
- frequently, the price of external funding is that the lenders or external investors will insist on a non-executive director. This is frequently the case in the growing family company where the non-executive may be instrumental in easing a company towards its next stage.

Practical considerations for the company:

- Is the board open to bringing someone in as a non-executive?
- What does the board want to gain?
- Is the board open to challenge and willing to take account of it?
- Are the executive directors willing to undertake further work to implement the non-executive's ideas and suggestions?
- What are the skill-sets required and the expected time frame of the appointment?
- Has an appropriate role specification been prepared?
- How will the board evaluate the non-executive's performance?
- How will the board resolve ineffective performance?

The board should make a considered decision, minuting its reasoning, and conclude for or against appointing a non-executive director. If the decision is made in principle to appoint one or more non-executive directors, the board should consider what it wants from the appointment(s) and the following points may be relevant.

Contribution to strategic leadership

The company management's role is to run the day-to-day activities of the business in accordance with the board's approved strategy. The benefits that are expected from a non-executive appointment would include a contribution to the development of that strategy and an effective challenge of management's strategic plans. The company should expect a non-executive director to:

- bring an external, independent perspective
- challenge executive recommendations
- assist in setting and revising strategy and objectives
- ensure that there are proper risk management and internal control frameworks which are implemented concerning all aspects of the business
- consider management's plans on succession planning.

Practical considerations for the company:

- The non-executive director will need appropriate induction to the company, as well as continuing development, in order to understand the business fully. This would normally include a tour of the facilities, meeting key workers, understanding the competition, understanding the key customers and the services or products and their unique selling points, meeting providers of finance and advisers etc.
- It can be very useful if a day is set aside off-site each year for a strategy session with the senior executives, the non-executive directors and an external facilitator all being present.

Independence

A non-executive director is expected to be someone from outwith the company, who can bring an external perspective to the board, is not involved in the internal running of the company, and does not have key relationships with the company, for example, as a supplier or customer.

Independence of mind does not mean that a director has to form his or her judgement in isolation. A director can obtain advice or information from others but the exercise of the judgement must be independent in the sense of it being his or her own judgement. The non-executive needs to be a strong enough character to be able to say 'no' and also credible so that he or she commands the respect of the board.

The company should expect the non-executive director to:

- scrutinise the performance of management against the objectives of the company
- seek to ensure there are systems which support the integrity and quality of management information
- help determine appropriate levels of remuneration of executives, and that there is not a culture of excessive reward or 'reward for failure'
- advise the board on the basis of his or her external knowledge and experience.

Practical considerations for the company:

- The board needs to be open to challenge, possible questioning and objective criticism.
- The appointment of an individual who is another interested party's representative, such as a financier or minority shareholder, needs to be fully discussed. It should be noted that it is a statutory duty of any non-executive director to promote the success of the company rather than the interests of a particular interested party or parties.
- The board needs to be willing to listen and discuss the non-executive's contribution; and to know how it might react if the non-executive fundamentally disagrees with a proposed course of action.

Skills and experience

An effective board should have a balance of skills and experience that is appropriate for the size and requirements of the business. Non-executive directors should add to the skills mix on the board and have suitable experience.

Practical considerations for the company:

- A decision to appoint non-executive directors should be made after identifying any skills gap on the existing board and considering the individual and collective skills and experience of the board.
- The potential non-executive director needs to be informed of what the company hopes he or she will bring to the company.
- Skills evolve and it may be useful to review periodically the skill-set of all directors, executive and non-executive, and to consider whether further training is required.

To be a part of the board

The board is collectively responsible for the success of the company and a non-executive director shares in that responsibility. The non-executive director should be expected to understand fully the business of the company, have good attendance at board meetings, be fully briefed, and to devote sufficient time to the role.

Practical considerations for the company:

- The non-executive director cannot fulfil the role unless he or she is provided by the company with appropriate information, adequate time to consider it, and adequate notice of board meetings.
- A non-executive director is not there just for board meetings and should be consulted by the management as appropriate. While the non-executive director will not spend the same amount of time with the company as the executive directors, he or she will spend time on the company's business outside meetings.

How do you find a non-executive director?

Having made a decision to seek a non-executive director, where are suitable candidates found? In general, the following are used:

- recruitment agencies
- informal business networks
- recruitment advertisements in newspapers or specialist journals as appropriate.

Practical considerations for the company:

- How many non-executive positions does the prospective appointee have?
- Will the prospective appointee have sufficient time to commit to the appointment?
- Are there likely to be conflicts of interest?

The terms of the appointment

Normally, any staff appointment will follow certain procedures. This should be equally applicable for a non-executive position. A non-executive director will:

- be on the board and be expected to have significant influence over the company
- be appointed for a specific (renewable) time period
- be remunerated.

Practical considerations for the company:

- A potential candidate for a non-executive position should be:
 - interviewed
 - references obtained and background checks undertaken, for example, has the candidate previously been disqualified as a director?
- Consider asking a prospective non-executive director to attend one, or part of, a board meeting as an observer before making the formal appointment.
- A letter of appointment should be issued, detailing the functions and time commitment that is expected as well as the period of appointment. Aspects that may be addressed in the appointment letter are included in Appendix A.
- Consideration should also be given to whether formal shareholder approval is required.

Removal of a non-executive director

It may be that despite the rigour of the recruitment process the performance of a non-executive director is not satisfactory. The appointment letter should reflect any notice periods or process for immediate removal.

Practical considerations for the company:

- Consideration should be given to a notice period of, say, three months, and
- An immediate removal process in specified circumstances.

2 What should a non-executive director expect from a company?

Working with a company associates that person with the company and the board, bringing the same liability as the executive directors and so carries risks for the individual to his or her reputation and, potentially, legal and financial risks. There will be rewards in terms of experience and remuneration but these need to be evaluated in relation to any potential risks.

Why consider accepting an appointment?

An individual may consider accepting an appointment as a non-executive director because it will broaden his or her experience and the non-executive director can often make a significant difference to the success and growth of a company. However, the potential non-executive director needs to be diligent in deciding whether to be associated with a particular company.

Practical considerations for the non-executive director:

- Do you know what the company wants from you?
- Do you have the required skills and industry knowledge?
- Will the company value your input and listen to your recommendations, even if you are being appointed by an external interest such as the bank or a minority shareholder?
- Are you aware of the board dynamics and whether you will be expected to be an arbitrator between different interests (family interests and/or different perspectives on the strategic direction of the company)?
- Are you confident and knowledgeable enough to challenge knowledgeable managers?
- Have you researched the company via publicly available information (e.g. web, press, annual report and accounts, marketing literature)?
- When, why and how would you consider exiting from the company, i.e. are you only planning to undertake the position for three years and, if so, is this what the company wants?

When deciding whether to accept an invitation to join a board the following points may be relevant.

Clarity regarding responsibilities

The non-executive director should have a clear understanding of what is expected from him or her and what powers and responsibilities he or she has under company and other legislation, the skills and expertise that the company wishes to utilise, and also the time commitment. This should include:

- a clear description of the role in the letter of appointment
- an appropriate fee
- director's liability insurance.

Practical considerations for the non-executive director:

- Meet with the company chairman, other directors, and senior management to discuss and agree the responsibilities before accepting the appointment.
- Talk to the company's advisers, e.g. the auditor or solicitor.

To be in a position to understand the business of the company

In order to understand the business of the company and to be able to participate effectively the non-executive director should:

- adequately understand the business and the company background
- obtain an induction programme about the company and, if necessary, non-executive training on powers and responsibilities
- ensure there is an annual programme of board meetings, with meetings held at regular, appropriate intervals, and with adequate time given to each agenda item
- receive board papers of an appropriate length and quality in order to prepare for meetings
- receive timely minutes that adequately reflect the discussions and decisions taken at the meetings.

Practical considerations for the non-executive director:

- Ensure that you are provided with suitable induction training and site visits in order to understand the business fully.
- It is useful to get occasional reports or presentations from senior managers who are not members of the board.
- Ensure that you can have independent access to the company's legal and accountancy advisers.

To be able to participate and contribute

The non-executive director should expect to be treated as a full member of the board and be in a position to participate fully. For example, the non-executive director should not be treated simply as an appointee if he or she represents external financial interests.

Practical considerations for the non-executive director:

- Make sure that you have advance notice of the board meetings and that you are given all the board papers in sufficient time to read them and to be able to ask for additional information if necessary. Generally, this should be one week in advance of the board meeting.
- Actively participate, and periodically go out and about around the company to understand its activities in order to be in a better position to assess what information is appropriate. As an effective member of the board you should not simply expect that all relevant information will come to you.
- Remember that no matter who has been involved in your appointment (e.g. a particular shareholder or the bank) the board is collectively responsible and that, as a member of it, you do not represent a particular interest.
- Have you the confidence and the independence to stand by your decisions and, if necessary, are you willing to resign if there is fundamental disagreement?

To have confidence in the identification of risk and the internal controls

The board has collective responsibility for the success of the company; however, the non-executive director is not involved in the company on a daily basis nor in the internal running of the company. It is essential, therefore, that the non-executive director has confidence that the key risks in running the company have been adequately identified and recorded, and are properly controlled. It is also necessary that reliable management information is presented to the board to allow the directors to make an assessment of the identification and management of the key risks.

Practical considerations for the non-executive director:

- You need to evaluate how risks are identified and controlled, and risk management strategies are properly implemented. See chapter 3 below.
- Check that a compliance schedule is in place and actively used so that the company fulfils statutory requirements such as making company and tax returns on time. (This is discussed in greater detail in the companion document 'Avoiding the Pitfalls in Running a Private Company'.)
- Review the audit management letter and/or meet with the auditors each year.
- Make sure that there is directors' liability insurance in place, with adequate cover, and that the premiums have been paid.
- Make sure that the risk of fraud has been analysed and appropriate safeguards put in place.

3 Managing the potential risks of being a non-executive director

A non-executive director's appointment associates that person with the company and the board and so carries risks for the individual to his or her reputation and, potentially, legal and financial risks.

Risk management and internal controls

A board's responsibilities include the key elements of risk management and internal controls and it is essential that the non-executive director is comfortable that these are appropriate and operate effectively. Not only does the non-executive director share collective responsibility for risk management but he or she is heavily reliant upon the internal controls existing and working properly. This is addressed more fully in the companion document 'Avoiding the Pitfalls in Running a Private Company', chapter 3.

Risk is an inherent part of being in business, and risk management is concerned with identifying, assessing, monitoring and mitigating risk, not necessarily removing it. Risks that a business face change regularly, and the system must be able to adapt, and must be able to escalate key issues and control breakdowns, reporting to the board as quickly as possible so that the board is fully aware, and can address the challenge. An effective system of internal control is key to robust risk management. There should be a clear set of documented procedures as part of an effective control system, and there need to be regular checks to ensure that the procedures are operating effectively.

Practical considerations for the non-executive director:

- Do risk management procedures exist; are they implemented in the business and are they working?
- How is the risk management undertaken and how often is the risk appetite statement or risk register reviewed and updated?
- Are appropriate measures taken to mitigate the risks identified?
- Does the board conduct a SWOT analysis periodically, which can be beneficial to identify key risks (and opportunities)?
- Professional advisers may be of assistance in identifying key risks and controls: has the company sought such assistance and, if so, acted upon it?
- Does the company have authorisation limits in place and is there immediate reporting and escalation when they are breached?
- Is there adequate segregation of duties, particularly where finance and stock are concerned?
- Are there regular accounting reconciliations and monitoring of cash flow forecasts?
- Are there suitable controls over incoming funds, expenditure and access to bank accounts?
- Is there adequate security of the premises and control over assets?
- Are the key people identified, and their substitutes or alternatives?
- Are there sound procedures for vetting and obtaining references for new employees?
- Is there suitable IT back up?
- Is there a suitable process for tracking legislative developments, impacts and risks?
- Is there a compliance schedule and is it properly used?
- Does the company have a comprehensive and tested business continuity plan?
- Has the risk of fraud been analysed and followed up?
- What insurance cover is maintained and does it cover key risks?

Getting into difficulties

A company may get into trading difficulties, either as a result of changing market conditions or through ineffective management and governance. These difficulties may lead to funding issues. Any non-executive director should be aware of the risks that arise in adverse trading circumstances and the impact of those risks. Seeking professional advice at an early stage from an insolvency practitioner or lawyer is recommended.

Directors must avoid wrongful trading. Wrongful trading occurs when a company continues to trade beyond the point at which the directors knew, or ought reasonably to have known, that the company had no reasonable prospect of avoiding an insolvent liquidation. A company is insolvent if it cannot pay its debts when they become due, the value of its assets are less than the liabilities, or both. In these circumstances, directors may be held personally liable for the company's debts if they did not take every step with a view to minimising the potential loss to the company's creditors.

There may come a point when it is clear that the company will not succeed and advice from an insolvency practitioner should be obtained as soon as possible. Seeking advice should assist the directors in the effective governance and management of the company and demonstrate that they have sought to avoid wrongful trading. As the non-executive director is remote from the day-to-day running of the company, it is particularly important that he or she remains aware of any signs that the company is getting into difficulties and gives management a robust challenge against any reassurances they may give.

Practical considerations for the non-executive director:

- Cash flow is essential, it should be monitored, and if available cash falls below pre-agreed monitoring levels the matter should be addressed immediately.
- Prospective sales should be analysed to establish how secure they are and whether there is a spread of customers or heavy reliance on just a few.
- Any banking covenants should be carefully monitored; any potential breach should be identified in advance and discussed immediately with the bank.
- Whilst the executive directors may be optimistic about the company's ability to survive a downturn, the non-executive director is expected to bring an objective, external perspective to the evaluation of a company's prospects.
- The company should discuss funding with the bank or investors to find out if they are supportive and will continue to be supportive.
- If there is unlikely to be any further financial support, and the company is unlikely to survive independently, an exit strategy should be pursued as soon as possible, such as looking for a sale of the company.
- If there is any risk of insolvency the board should take early advice from an insolvency practitioner.

Criminal offences

The following constitute offences:

- concealing, destroying property and records
- falsifying company records
- being privy to the above.

Director's Disqualification

The recurring themes in corporate scandals over the last decade or so include false accounting, fraud by one or more of the senior staff or directors, tax evasion, lack of internal controls, a dominant or charismatic CEO or Chairman, or major strategic blunders. A diligent non-executive director who takes proper advice should not find him or herself in the position of being disqualified as a result of failing to exercise his or her duties.

4 Duties and Responsibilities of a Director

The Companies Act 2006 has codified the duties of directors. These statutory duties are applicable to all directors regardless of the size of the company and regardless of whether the director is an executive or non-executive appointment. There are seven general duties for directors, which are listed below with a number of practical considerations that are offered as points that directors may wish to consider to identify whether and how they fulfil their duties. This guide is not a legal document and, where appropriate, legal advice should be sought.

- 1 A director must act in accordance with the company's constitution and only exercise powers for the purpose for which they are conferred.

Practical considerations for the non-executive director:

- The non-executive director should read and understand all relevant documents and should act within them. These would include the articles of association and, in a company formed before the Companies Act 2006 was implemented, the memorandum of association.
- In some companies there may also be shareholder agreements and bank facility agreements that contain restrictions on what the company may do without certain consents or approvals.

- 2 A director must act in the way he or she considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to the likely consequences of any decision in the long term; the interests of employees, the community and the environment; and the desirability of the company maintaining a reputation for high standards of business conduct.

Practical considerations for the non-executive director:

- The board minutes should be an adequate reflection of discussions, challenge from non-executive directors, decisions, the reasons decisions were made, and that they were taken in the interests of promoting the success of the company whilst giving appropriate consideration to the wider stakeholders.
- No matter who has been involved in the appointment (e.g. a particular shareholder or the bank) the board is collectively responsible and a non-executive director must not represent a particular interest.

- 3 A director must exercise independent judgement.

Practical considerations for the non-executive director:

- As discussed in chapter 1 the non-executive director should operate in an objective and independent manner.
- The non-executive director may obtain independent professional advice to assist him or her, when necessary, in reaching a judgement. This should be at the company's cost. This should also be addressed in the letter of appointment.

- 4 A director must exercise the care, skill and diligence of a 'reasonably diligent person' having both the general knowledge, skill and experience reasonably expected of a director in his or her position (objective test), and the general knowledge, skill and experience which he or she actually has (subjective test).

Practical considerations for the non-executive director:

- A non-executive director who is knowledgeable on a particular subject, whether through experience or qualification, is expected to provide a higher level of expertise on that subject than one who does not have that knowledge, and will have a correspondingly higher degree of responsibility and potential liability.
- A non-executive director with specific professional qualifications such as a qualified accountant, lawyer, or banker should remember that he or she is one of a collective board and should ensure that fellow directors are made aware of matters for which they are responsible, e.g. the terms of financial instruments, potential legal issues, the possibility and impact of breaking a financial covenant, etc. Such a director may wish to ensure that on matters where it might be possible that the company is relying on him or her that appropriate external advice is obtained. A non-executive director with such professional qualifications is not engaged as a professional adviser to the board and should ensure the board is aware of this fact at all relevant times, particularly when advice is being sought.
- A non-executive director with specific qualifications, such as an accountant or lawyer, can have high and perhaps unrealistic expectations placed on him or her by both the company and the public – it is important that areas of expertise are identified and expectations managed as to what is reasonable.

- 5 A director must avoid a situation in which he or she has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.

Practical considerations for the non-executive director:

- Actual and potential conflicts of interest should be identified and managed, for example, other directorships or employments, appointments by a particular stakeholder group, or shareholdings in a supplier or competitor. The board can authorise conflicts if the articles allow this.
- Any possible conflicts should be declared before discussions start and, if need be, the director concerned should be excused from the meeting whilst the matter is discussed and there is any formal vote on the matter.
- An equity holding in the company of which a person is a non-executive director should not produce a conflict, but a loan or a preference holding could well mean that the director has a different interest from the owners of the company.

- 6 A director must not accept any benefit connected with his or her role as a director from a third party unless it cannot reasonably be regarded as likely to give rise to a conflict of interest.

Practical consideration for the non-executive director:

- The critical decision is the scale of any benefit, and external perceptions as to whether it might influence the director's behaviour. For example, it may be that a lunch is considered acceptable whereas a more substantial benefit such as a holiday is not.

- 7 A director must declare the nature and extent of any personal interest in a proposed transaction with the company to the other directors before the company enters into the transaction.

Practical consideration for the non-executive director:

- In general, the position of the non-executive director is such that he or she should not have loans, credit transactions, or substantial transactions with the company. The Companies Act 2006 contains a prohibition against certain of these transactions unless shareholder consent is obtained.

Other duties that a director should consider

Whilst not exhaustive, other duties that a director should consider include:

- duty of confidentiality
- duty to devote time and attention
- duty to account to shareholders
- duty not to make 'secret profits'
- stewardship of the company assets
- a general duty to act in good faith
- duty to maintain books of accounts
- duty to file accounts, annual returns, and tax returns
- duty to maintain statutory books
- duty to ensure the company is complying with legislation including, in particular, those involving risk to third parties, for example, health and safety at work.

Connected persons

Some directors' responsibilities extend to their 'connected persons', for example, the requirement to have their actual or potential conflicts of interest authorised. The Companies Act defines connected persons fully, but mainly this extends to a director's spouse, partner or children.

Appendices

Appendix A: non-executive director's appointment letter

The following aspects may be addressed in the non-executive director's letter of appointment:

- the date from which the appointment is effective
- the period of appointment (e.g. three years)
- state that it is a contract for services (non-executive directors) and not a contract of employment (executive directors)
- termination procedures, for example, at the discretion of either party with one/three months' notice or immediate, and indicative circumstances where immediate removal would occur
- the expected time commitment, of x number of days per annum, including attendance at all board meetings
- the legal responsibilities of a director
- the specific responsibilities expected in this appointment
- fees and expenses, the basis of payment
- whether and to what extent external professional advice may be sought at the company's expense
- outside interests, and management of any potential conflicts of interest
- confidentiality of information known during and after the period of the contract
- an anti-competitive clause for the duration, and a period after, the contract
- induction procedures
- directors' liability insurance.

Appendix B: other sources of useful information

- **The Institute of Chartered Accountants of Scotland (ICAS):** www.icas.org.uk/business
'Avoiding the Pitfalls in Running a Private Company', is a companion document to this publication, which provides guidance on the principles of governance and how these may be applied in the private company as it develops.
- Financial Reporting Council (FRC): www.frc.org.uk
The FRC is the UK's independent regulator responsible for promoting confidence in corporate reporting and governance. The FRC publishes the 'Combined Code on Corporate Governance'. It also has further guidance such as the Turnbull Report 'Internal Control: Guidance for Directors on the Combined Code', which has subsequently been revised and reissued by the FRC; and 'Good Practice Suggestions from the Higgs Report', which covers the role and effectiveness of non-executive directors.
- A list of insolvency practitioners licensed by the Institute can be found on the ICAS website: www.icas.org.uk
- The Institute of Directors (IOD): www.iod.com
The IOD supports, represents and sets standards for directors.
- Her Majesty's Revenue and Customs: www.hmrc.gov.uk
Guidance can be found regarding tax matters such as PAYE, corporation tax and value added tax.
- International Federation of Accountants (IFAC): www.ifac.org/paib
The International Center for Professional Accountants in Business, hosted by IFAC's Professional Accountants in Business (PAIB) Committee, provides resources and facilitates the exchange of knowledge and best practices among the more than one million professional accountants worldwide employed in commerce, industry, the public sector, education, and the not-for-profit sector.



CA House • 21 Haymarket Yards • Edinburgh • EH12 5BH
Tel: 0131 347 0240 • Fax: 0131 347 0114
Email: accountingandauditing@icas.org.uk • Website: www.icas.org.uk