

Governance lessons from finance company prosecutions?

Good governance must include legal compliance, business competence and ethical standards. The prosecution of directors for their part in finance company collapses has highlighted these essentials. The key question with all board decision making is not what can be done? But *what should be done?*

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and its stakeholders. Corporate governance provides the structure through which a company's objectives are set and the means for determining how those objectives are to be attained and how performance is to be monitored.

'I relied on what the manager/lawyer/accountant told me' is not sufficient

A director's ability to rely on advice received from management or external advisers remains qualified. Advice cannot be relied on where the circumstances suggest a need for further enquiry. External advisers and senior executives are technicians whose role is quite separate from directors. The reasonableness of reliance on external advice is limited to the scope of the work the adviser was asked to do and depends on how much the adviser knows and the accuracy of the information given to them.

The fact that an issue is not raised in external or management reports will not protect a director where a reasonable director would have been put on notice that an issue existed.

'Not my job'

Where the company is in crisis, the board (and in particular, the chair) will need to be more involved in the operational side of the business.

If a director is aware of a potential problem he or she cannot leave it to management (or other directors) to deal with. All directors have a responsibility to ensure that they understand the company's business and its financial position (however they do not need to have the skills of a forensic accountant).

Directors are appointed to exercise judgement, and that extends to testing the competence of management within areas in which the managers are relied upon.

All directors must make proper enquiry where it is warranted. A director who is aware that the company is not acting appropriately should take steps to ensure that the situation is remedied or, failing that, resign.

'What conflicts?'

Where the personal interests of a director conflict with the interests of the company, the director must disclose those personal interests to the board. If a director is permitted to participate in discussions where he or she is conflicted that will affect the board's discussion and possibly its decision.

A common area of conflicted interests is where a director sits on the boards of two or more related companies. The criteria for entering into transactions with related companies should be no different from the criteria for entering into any arm's length transaction.

The standard for directors' decisions

The actions of directors are evaluated on the basis of the range of reasonable options open to directors, in the circumstances they face at the time a decision is made.

Recent finance company cases have not made any new law but have highlighted the importance of good governance, the harm that poor governance can involuntarily cause to vulnerable investors and the serious consequences that the courts will impose on the offending directors.