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Chapter 3 – Corporate Governance Roles

3. CORPORATE GOVERNANCE ROLES

3.1 Corporate Governance

James D. Wolfensohn, the former head of the World Bank, stated that, "the governance of the corporation is now as important in the world economy as the government of countries."

The term "corporate governance" is susceptible to both narrow and broad definitions. Narrowly defined, it concerns the relationships between corporate managers, directors and shareholders. It can also encompass the relationship of the corporation to stakeholders and society. More broadly defined still, "corporate governance" can encompass the combination of laws, regulations, listing rules and voluntary private sector practices that enable the corporation to attract capital, perform efficiently, generate profit, and meet both legal obligations and general societal expectations.

Corporate governance is the system by which companies are managed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors, and to satisfy themselves that an appropriate governance structure is in place.

Corporate governance has become a major issue in business circles. Investors are seeking greater accountability from companies. As a result of several bad practices of well-known public companies in the late 1980s, early 1990s and 2000s, companies have acted to regain investor confidence by reviewing the way they are governed and by establishing corporate governance systems.

Corporate governance deals with issues such as:

- the responsibilities and functions of the company's board, including setting strategic direction and monitoring the performance of management;
- board membership and composition;
- board committees for audit, risk, compliance, executive remuneration, etc.;
- independent external advice available to each director;
- management of business risks (risk management) and the effectiveness of the company's system of internal control; and
- ethical standards (code of conduct).

This booklet focuses on corporate governance from the perspective of the new credit union or building society director commencing their journey along a steep learning curve. The topics in this section along with many other topics embraced within the evolving field of corporate governance are covered in more detail in two other key publications provided by AMInstitute specifically for credit union and building society directors:

- **The Mutual ADI Directors' Compliance Manual (Version – update annually) and**
- **Mutual ADI Corporate Governance Manual**

Disclosure of Corporate Governance Structure (An Example)

This example may also be used to show to shareholders and potential investors how a company's policy of corporate governance is adopted, by outlining the steps taken by management for this purpose, in its annual report.

Example: The directors of ABC Pty Ltd adhere to corporate governance practices based on the Australian Stock Exchange Limited Listing Rules, even though the company is not a listed public company.

Role of the board

The board has the overall responsibility for corporate governance. It sets the strategic direction of the company and the goals for management. Day-to-day operations and administration are delegated by the board to the Chief Executive and his/her management team.

Members of the management team may be invited to board meetings when their areas of operational responsibility are considered.

The board reviews the plans of management, and monitors the performance of management against those plans in achieving the established goals.

Board membership

The board has six directors comprising a non-executive chairman and five non-executive directors.

All directors are appointed by and accountable to the members. The Constitution of the company provides for a proportion of the directors to retire by rotation each financial year. Retiring directors are eligible for re-election.

Board committees

To assist the board in achieving the highest standards of corporate governance, the directors closely involve themselves with the critical areas of the company's

activities through the establishment of board committees with specific responsibilities for audit, compliance, risk and remuneration.

The CEO attends all committees together with other directors and managers as required. The audit committee has been established to provide additional assurance regarding the quality and reliability of financial information used by the board and the financial statements issued by the company to its shareholders.

The committee reviews the activities of the internal audit group and liaises with the company's external auditors. They both have direct access to the committee Chairman and oversee compliance with statutory responsibilities relating to financial disclosure including related party transactions.

The committee also reviews the performance of the audit group on an annual basis.

The compliance committee is responsible for monitoring legal, and procedural requirements to ensure the company is complying with all regulatory requirements.

The committee monitors procedures, which are designed to ensure the reliability and integrity of all information technology systems and the review of IT development projects.

The remuneration committee advises the board on remuneration policies for the executive directors, senior executives and managers of the company.

In accordance with the constitution, the remuneration of non-executive directors is set by the shareholders.

Independent external advice

An individual director has the right to seek independent professional advice on particular matters before the board, subject to approval from the chairman, at the company's expense.

Business risks

Established procedures at board and management level are designed to maintain the company's operational viability and to safeguard its assets and interests and ensure the integrity of its reporting. These include accounting, financial reporting and internal control procedures and limits, which are subject to internal and external audit review.

Ethical standards

The directors acknowledge the need for the highest standard of corporate governance practices and ethical conduct by all directors, employees and contractors of the company.

Risk Management – AS/NZS 4360:2004

Risk management involves managing to achieve an appropriate balance between realizing opportunities for gains while minimising exposure to losses. It is an integral part of good management practice and an essential element of good corporate governance.

Risk management involves establishing an appropriate infrastructure and culture and applying a logical and systematic method of establishing the context, identifying, analysing, evaluating, treating, monitoring and communicating risks associated with any activity, function or process in a way that will enable organisations to minimise losses and maximise gains.

To be most effective, risk management should become part of an organisation's culture. It should be embedded into the organisation's philosophy, practices and business processes rather than be viewed pr practiced as a separate activity. When this is achieved, everyone in the organisation becomes involved in the management of risk.

Although the concept of risk is often interpreted in terms of hazards or negative impacts, it is actually concerned with risk as exposure to the consequences of uncertainty, or potential deviations from what is planned or expected. The process described here applies to the management of both potential gains and potential losses.

Organisations that manage risk effectively and efficiently are more likely to achieve their objectives and do so at lower overall cost.

Nexus with Corporate Governance

Corporate governance is the prime responsibility of the board of directors. It focuses on three key objectives:

- To protect and reinforce the rights and interests of stakeholders, especially in areas concerning conflicts of interest.
- To ensure the board properly fulfils its primary responsibility to direct strategy and monitor the performance of the organisation, particularly with regard to assessing the performance of senior management.
- To ensure that management controls and reporting procedures are satisfactory and reliable.

Management control, including the development of an effective response to risk (ie risk management), is interwoven into these three elements of corporate governance.

Directors cannot be responsible for the day to day risk management of a company. They should however determine the company's risk management policy and overall strategies. They should also be responsible for clearly communicating the policy and strategy to management and informing the public of the company's risk management philosophy.

Although directors can delegate responsibility to management for implementing a risk management system, they cannot abdicate responsibility for its implementation.

Principles of Corporate Governance set down by NZ Securities Commission

The New Zealand Securities Commission has set down the following nine principles: -

- Ethical standards
- Board composition and performance
- Board committees
- Reporting and disclosure
- Remuneration
- Risk management
- Auditors
- Shareholder relations
- Stakeholder interests

The Securities Commission conducts wide – ranging reviews and investigations, and routinely names organisations who fail to meet minimum standards of corporate governance. This currently follows the New Zealand regulatory practice of disclosure in preference to enforced compliance.

The Reserve Bank of New Zealand Amendment (No. 3) Act 2008
Requirements of bank and non bank deposit takers:

- Maintaining a minimum amount of capital and a minimum capital ratio
- Credit Rating if risk weighted assets exceed twenty million
- Maintaining a minimum level of liquid assets
- Applying governance standards – boards required to meet fit and proper person requirements
- Maintaining risk management programmes

3.2 Director Information

Number of directors

The ***Corporations Act*** requires all public companies, to have at least 3 directors, not including alternate directors. Two of the directors must ordinarily reside in Australia. There is no limit on the maximum number of directors. Prudential Standard APS 510 requires all ADIs to have a minimum of 5 directors.

Qualification requirements

The requirements for eligibility to be a director are set out in the Corporations Act; the Constitution; the Banking Act and the Australian Prudential Standards APS 510 – Corporate Governance and APS 520 – Fit and Proper. (Refer to Sections 3.14 for requirements relating to the Banking Act & Prudential Standards).

Under the *Corporations Act*, a person must satisfy the following requirements to be a director:

- the person is an individual;
- the person is at least 18 years old; and
- if the person has been disqualified from managing a corporation under the ***Corporations Act***, ASIC has given the person written permission to manage the company, or the Court has given the person leave to manage the company.

Under Principle 27 of the Principles of Mutuality of the affiliated Movement only a member of the credit union can be a director. The Constitution can include additional eligibility requirements (such as residency requirements or minimum periods of membership). The Constitution can also provide for one or more directors, as long as they are in the minority, to be "appointed directors" that are not necessarily members.

Under the Corporations Act, a person is automatically disqualified from managing corporations if:

- the person is convicted of certain types of offences involving management of corporations, breaches of the *Corporations Act*, dishonesty or significant prison terms; or
- the person is an undischarged bankrupt under Australian or foreign law, or has entered into an arrangement or composition with creditors and the terms of the arrangement or composition still have to be complied with.

The Court may disqualify a person from managing corporations if:

- the person has breached a civil penalty provision in the *Corporations Act* and the Court considers that disqualification is justified;

- within the past 7 years, the person has been an officer of 2 or more corporations when they have failed; and the Court considers that: -
  - the management of the corporation was wholly or partly responsible for its failure; and
  - that disqualification is justified;
- the person has:
  – been an officer of a corporation that has contravened the *Corporations Act* at least twice (unless the person took reasonable steps to avoid contravention); or
  – contravened the *Corporations Act* at least twice; or
  – otherwise breached their duties of care, diligence and skill and good faith to a body corporate:

ASIC may disqualify a person from managing a corporation if, within the past 7 years, a person has been an officer of 2 or more corporations and they have been wound up on grounds of insolvency either while the person was an officer, or within 12 months of the person ceasing to be an officer (*section 206F*).

ASIC maintains a Disqualified Persons Register on its website**:** www.asic.gov.au**.** This Register is not a complete list of **ALL** disqualified persons. However, it lists persons who have been disqualified from managing corporations either by the Court or by ASIC. It does not include people who have been automatically disqualified from managing corporations because they have been convicted of certain offences or are bankrupt.

The Insolvency and Trustee Service Australia (ITSA) maintains a National Personal Insolvency Index containing details of persons' bankruptcy. To check whether a person is bankrupt, you can contact the Insolvency and Trustee Service Australia (ITSA). ITSA or an information broker with access to the National Personal Insolvency Index will check for you whether a person is an undischarged bankrupt for a small fee. Refer to www.law.gov.au/itsa/documents/np_search.html

Qualification - Directors 72 years (age restrictions no longer apply)

Until 11 April 2003 the *Corporations Act* set out special rules for:

- a director turning 72 during their term; and
- a person over 72 seeking election as a director.

Those age restrictions were removed from the Corporations Act by the *Corporations Legislation Amendment Act 2003*, Item 7 of Schedule 5.

However, while section 201C has been repealed, the ADI is still bound by any age restrictions in its Constitution until the members vote to remove that restriction.

APRA – Banking Act – 'Fit & Proper' qualifications

The Financial Sector Legislation Amendment Bill (No 2) 2002 was passed in November 2003 with commencement scheduled for February 2004.

This legislation introduced a 'disqualified persons' provision that creates an offence for an ADI to employ a 'senior manager' (someone performing senior manager functions) or have as a director a 'disqualified person'.

APS 520 Fit & Proper Prudential Standard implemented by APRA on 1st October 2006 embellished ADI responsibilities in this area.

The categories for disqualified person are wide, and include having any previous dishonesty offences, bankruptcy or bankruptcy relief, breaches of the Banking Act or Corporations Act, amongst other categories.

Types of Directors

Alternate Directors

Apart from ordinary directors, the *Corporations Act* allows for the appointment of Alternate Directors. With the other Directors' approval, a director can appoint an alternate to exercise some or all of the Director's powers for a specified period. The company is required to give the alternate notice of Directors' meetings if the appointing director requests. An alternate exercises the Director's powers just as effectively as if the Director exercised the powers. The appointing Director may terminate the alternate's appointment at any time. The appointment or termination must be in writing and a copy must be given to the company. ASIC must be given notice of the appointment.

Employee Directors

The Corporations Act makes no distinction between ordinary Directors and employee Directors. There is nothing in the Corporations Act that would prevent the appointment of an employee to the position of Director. However, provisions of the Constitution may contain restrictions on employees being appointed or elected as Directors. Employee Directors are also known as "Executive Directors".

It must be noted that an employee of an ADI is prohibited from being the Chairperson by virtue of Prudential Standard APS 510 – Governance.

Election or appointment of directors

Consideration must be given to the board's power to appoint Directors:

- to fill a casual vacancy; or
- to fill a vacancy otherwise than as a casual vacancy – an example of this would be when there are less candidates for election than vacancies available to be filled.

The Constitution governs when and how the board may appoint a person as a Director in these circumstances.

To appoint a person as a Director by a board resolution: -

- the Board must have the power to do so under the Constitution; and
- the person must be eligible to be a Director;
- the person must consent to act as a Director.

Appointment by Board

Depending on the terms of your Constitution the board may appoint a new director if:

- a director's office becomes vacant, (other than because the term of the director's office has expired at the end of an annual general meeting); or
- if the number of directors is less than the number provided by the Constitution.

Consent to Act as Director

The company must obtain a person's signed consent to act as director before appointing the person as a director. Your company commits an offence if it appoints the person as a director before obtaining their signed consent. The company must keep the signed consent.

Board Resolution to appoint

The board may pass a resolution appointing the person as a director at a board meeting or as a circulating resolution. Careful consideration must be given to section 203E of the *Corporations Act*. It provides that a request or notice of any or all of the directors of a public company is void to the extent that it purports to:

- remove a director from their office; or
- require a director to vacate their office.

Therefore, advice should be sought concerning the terms of appointment of a director, especially with respect to the term of office of a director not otherwise appointed by the members of the credit union.

Term of Office for Directors Appointed by the Board

The Constitution may provide that the term of a director appointed by the board ends:

- if the director is appointed to fill a casual vacancy – at the end of the term of the director whose position has become vacant (other than because the term has expired);
- if the director is appointed to fill a vacancy by reason of the number of directors falling below the number specified by the constitution – at the end of the AGM next after the director's appointment.

Companies are free to select their own constitutional provision as to the term of a director appointed in these circumstances.

Resignation of Directors

The office of a director of a company will become vacant if the director gives written notice to the company of their resignation. However, there is no legal requirement for the company to accept the resignation in order to bring it into effect.

The departing director will remain on the company register as an officer of the company until the company lodges a duly completed Form 304 with ASIC advising of the resignation. This must be done within 14 days of notice of the resignation. Until such time as the form has been lodged, the director is still regarded prima facie as a director of the company.

Alternatively, the director may notify ASIC directly of the resignation, using Form 370. A copy of the letter of resignation sent to the company must be attached.

Removal of Directors and Vacation of Office

Overview

The circumstances in which a person ceases to be a director are set out in:

- the Corporations Act; and
- the credit union's or building society's Constitution.

It is also the case that a director can cease to hold office if removed by APRA under the Banking Act as not being fit and proper.

There is no restriction in the *Corporations Act* on the term of a director. The credit union or building society's constitution can specify any term.

Disqualification from managing corporations

A person ceases to be a director of the company if the person becomes disqualified from managing corporations under the *Corporations Act* unless ASIC or the Court allows them to manage the ADI.

Removal by General Meeting

A general meeting may remove a director from office by ordinary resolution.

The general meeting retains this right despite anything in:

- the company's constitution (if any); or
- an agreement between the company and the director; or
- an agreement between any or all members of the company and the director.

Notice of the resolution to remove the director from office must be given to the company at least 2 months before the general meeting is held. However, if the company calls a general meeting within 2 months after receiving the notice, the meeting can still pass the resolution.

The company must give a copy of the notice proposing the resolution to remove the director to that director as soon as possible after receiving it.

The director has a right to put their case before the members by:

- giving the company a written statement for circulation to members; and
- speaking to the motion at the meeting.

The company must send a copy of the director's statement to all the members before the general meeting if there is time to do so. If there is not time to do so, the company must distribute a copy of the director's statement to the members at the general meeting and read it out at the meeting before the resolution is voted on. The company does not have to distribute the director's statement if it is more than 1,000 words long or is defamatory.

No Removal by Board or Directors

Neither the board nor any director of a company may by resolution, request or notice:

- remove a director from his or her office; or
- require the director to vacate his or her office.

Any such resolution, request or notice is void

3.3 Directors' Duties

The common law principle of the duties of directors is to act honestly, to exercise reasonable care and skill, to be diligent and to be aware of and understand the fiduciary duties of a director.

Fiduciary Duties

A wide range of duties are imposed upon directors and others who engage in management. These duties are far stricter and involve greater potential liabilities than is the case with employees. It is therefore important to distinguish between employees and management.

The duties of directors are based on the traditional rules dealing with fiduciary relationships. In these relationships, the fiduciary deals with property that belongs to someone else who is dependent on the fiduciary's honesty and skill. Fiduciary duties are owed by a wide range of people including trustees, partners, agents, professionals and directors.

These fiduciary duties have been developed by the courts over a long period of time. In more recent times there has been substantial development of complementary legislation contained in the Corporations Act. In many respects the *Corporations Act* adds to these duties of directors and imposes additional responsibilities.

Under common law principles, a director must act honestly; exercise reasonable care and skill; be diligent, aware of and understand the fiduciary responsibilities of their position. This can be summarised as the duty to:

- act bona fide in the interests of the company (act in good faith);
- exercise care, skill and diligence;
- exercise the powers for the purpose for which they were conferred;
- retain their discretionary powers; and
- avoid conflicts of interest.

The fiduciary duties of a director require the director to act bona fide in the best interests of the company as a whole, with the fiduciary duties being owed individually by each director.

Statutory duties

In addition to the fiduciary duties owed by a director, there are extra statutory duties imposed under Section 18D of the *Corporations Act*. In so far as these duties apply to directors, to a large extent they restate and reinforce the general law (or fiduciary) duties imposed on directors.

The statutory duties under section 180 are civil penalty provisions, and operate in addition to any general law duties.

The provisions of section 180 extend the application of the civil penalty provisions beyond directors, secretaries and executive officers of a company to include:

- A receiver, or receiver and manager of a corporation;
- Administrators;
- A liquidator of the corporation; and
- Trustee acting on behalf of the corporation.

- The civil penalty provisions are extended to include those involved in the management of a corporation in financial difficulties, and as such are expected to abide by the same duties and responsibilities of officers and directors of solvent companies.

Penalties

If a director fails to fulfil his or her duty the director may be liable for significant fines plus any compensation for damage or loss resulting from his or her breach of duty.

A director may also be criminally liable if he or she:

- fails to act in good faith in the best interests of the credit union or building society and for a proper purpose; or
- uses his or her position or information he or she has acquired as a director to gain an advantage for themselves or others, or to cause detriment to the company; and
- is reckless or intentionally dishonest in doing so.

Duty to act in good faith

The duty to act in good faith (bona fide) is an overall common law duty. A director owes the credit union or building society the fiduciary duty to act in good faith. This requires the director to act for the benefit of the mutual ADI and not, by any act not compatible with the position of director, to harm the mutual ADI's business to further the director's own interests. Directors must not put themselves in a position where their duties and interests conflict, and they must make full disclosure to the Board of Directors at the earliest opportunity of any potential conflicts of interest.

Directors must retain their independence and not act in accordance with the wishes of a third party.

This common law duty is reinforced by the statutory provision in section 181of the *Corporations Act* which provides that a director must exercise their powers in good faith in the best interests of the corporation and for a proper purpose.

The courts have interpreted this duty to act 'honestly' in common law terms to mean acting in good faith and in the best interests of the company.

Duty to Members

In the case of companies, the duty to act in the best interests of the company as a whole has been considered by the courts to mean in the interests of the shareholders as a collective group; however this does not mean that a director owes duties to particular shareholders.

Duty to Creditors

A director is required to consider the interests of the creditors where the company is insolvent or is likely to become insolvent. The interests of the creditors become paramount due to the fact that the members no longer have an important interest in the company.

The liquidator will closely scrutinise the actions of the director and if it appears that the director's duties were breached to the detriment of creditors, the liquidator may try to recover funds from the directors in order to increase the pool of assets of the company. The duty to act in the interest of creditors of the company may also extend to future creditors of the company.

The duty to creditors is particularly dangerous to passive or sleeping directors. Due to the increased standards of care expected of directors, they must pay close attention to whether a company is insolvent or not. A director can no longer avoid liability by claiming to be ignorant of the financial position of the company.

A breach of the duty to creditors also attracts civil penalty provisions. However, creditors cannot bring a civil action against directors to recover their losses. The director owes a fiduciary duty to the company, and as a result it is only the company that has the remedy available for a breach of that duty. However, where a company has been wound up, civil action can be brought by the liquidator against the directors for a breach of duty and any amount recovered from them is available for distribution to creditors.

Duty of Care, Diligence and Skill

The area of directors' duties that has developed the most in the past few years is the duty of care, skill and diligence. In response to community expectations regarding the ability of all directors, the courts and the Corporations Act have imposed higher standards.

A director is now expected to display a degree of care that is reasonable to expect from a director of that type of institution. Previously, directors only had to display the degree of care that they would in the conduct of their own business affairs.

Section 180(1) of the *Corporations Act* requires that a director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:

- were a director or officer of a corporation in the corporation's circumstances; and
- occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.

Business Judgement Rule

Under the *Corporations Act* the directors of a company gain some protection from liability for their decisions by the operation of the business judgment rule which came into effect from 1st March 2000 as part of the implementation of Clerp 1-4.

The business judgment rule is set out in Section 180(2) of the *Corporations Act*. The substance of the rule is that a director is taken to meet the requirements of the statutory duty of care and diligence in Section 180(1) and the equivalent duties at common law and equity, in respect of a business judgment they make, if the director:

- makes the judgment in good faith for a proper purpose;
- does not have a material personal interest in the subject matter of the judgment;
- informs himself or herself about the subject matter of the judgment to the extent that he or she reasonably believes to be appropriate; and
- rationally believes that the judgment is in the best interests of the company.

The director's belief that the judgment is in the best interests of the company is deemed to be rational unless the belief is one that no reasonable person in the director's position would hold.

The effect of the business judgment rule is that the courts will not inquire into whether the judgment made by a director was in the best interests of the company so long as it appears to have been made honestly and is not a totally irrational decision for a director of that company to make.

WARNING
The statutory business judgment rule only gives a director protection from liability under the statutory duty of care and diligence and the equivalent duties at common law and equity. It does not give a director protection from liability under the other *Corporations Act* directors' duties.

Exercising Reasonable Care

The director's circumstances must still be taken into account in determining whether the director failed to exercise reasonable care. Directors are entitled to delegate to management and rely on the mutual ADI's management to properly perform its tasks.

In *Re City Equitable*, Romer J indicated that directors are entitled to delegate responsibilities and can rely on them to perform the tasks. It was stated:

"In respect of all duties that, having regard to the exigencies of business, and the Articles of Association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly."

However, just because directors are entitled to delegate and rely on others does not mean that the director need not have an understanding of the business of the company. In the AWA case it was stated:

"A director is obliged to obtain at least a general understanding of the business of the company …. Directors should bring an informed and independent judgement to bear on the various matters that come to the board for decision."

and further:

"A director is justified in trusting officers of the corporation to perform all duties that, having regard to the exigencies of business, the intelligent devolution of labour and the articles of association, may properly be left to such officers.

Reliance on information provided by others and delegation of responsibilities

Section 189 Reliance

Directors are expressly allowed to rely on the advice or information provided by experts when making decisions as long as the director believes on reasonable grounds that the person relied upon is reliable and competent in relation to the matters concerned.

A director may rely on information or professional or expert advice supplied by:

- an employee of the corporation whom the director believes on reasonable grounds to be reliable and competent in relation to the matters the subject of the employee's advice; or
- professional advisers or experts where the director believes on reasonable grounds that the relevant matters are within the person's professional or expert competence advice; or
- another director or officer in relation to matters within the director's or officer's designated authority advice; or
- a committee of directors on which the director did not serve in relation to matters within the committee's designated authority advice.

Duty to exercise powers for their proper purpose

In exercising their powers, directors must be motivated to act in the company's interests and not for some other purpose or in their own self interest. Directors may breach this duty even if they have acted honestly and believe that their actions have been in the best interests of the company.

In Mills v. Mills (1938) 60 CLR 150, it was considered that:
"*Directors of a company are fiduciary agents, and a power conferred upon them cannot be exercised in order to obtain some private advantage or for any purpose foreign to the power*."

Additionally, a director may be in breach of the duty to exercise powers for a proper purpose even though not involved in a particular transaction. The duty is breached if the director knew of the improper purpose of the other directors and failed to take steps to prevent the transaction from proceeding (Permanent Building Society v. Wheeler (1994) 12 ACLC 674).

Officers or employees of a corporation must not inappropriately use their position to gain an advantage for themselves or cause detriment to the corporation. In addition, information obtained by an officer or an employee of a corporation must not improperly be used to gain a benefit or cause harm to the corporation.

Duty to prevent insolvent trading

A director is under a duty to prevent his or her company from trading whilst insolvent. A director breaches this duty if he or she fails to prevent the company incurring debts if there are reasonable grounds for suspecting that it is insolvent.

Subject to four alternative defences set out in section 588H, contravening directors are liable to pay compensation to the company of an amount equal to the loss or damage suffered by unsecured creditors in relation to the debts so incurred because of the company's insolvency.

The duty to prevent insolvent trading applies to a person who is a director at the time when the company incurs the relevant debt. The duty is imposed only on directors because they control the management of the company and have the ultimate power to prevent debts being incurred.

Duty to Avoid Conflicts Of Interest

A director must avoid situations where there is a real possibility of conflict between their personal interests and the interests of the company.

Where a conflict does arise, full disclosure must be made to the board of directors. A director must be aware of both actual and potential conflicts of interest.

This duty is designed to prevent directors from making a profit out of acting as a director and further, prevents directors from putting themselves in a position where it appears they may be acting in their own interests. As a general rule, a director breaches this duty even though they may not have made a profit, the company may not have suffered a loss, or the terms of the contract were fair.

Under the *Corporations Act* the directors of the company must give notice of any material personal interest they have in any matter relating to the company.

Notice of Material Personal Interest

A director who has a material personal interest in a matter that relates to the affairs of the company must give the other directors notice of the interest.

The director does not have to give this notice if:

- the interest is of a type listed in section 191(2)(a); or
- the director has already given notice of the nature and extent of the interest to the directors, either in relation to the same affairs of the company or as a standing notice.

The notice given by the interested director must:

- give details of the nature and extent of the interest;
- give details of the relation of the interest to the affairs of the company; and
- be given at a board meeting as soon as practicable after the director becomes aware of their interest in the matter.
- the details of the directors' notice must be recorded in the minutes of the meeting.

Personal Profits

Directors are under a duty not to make personal profits while acting as a director. This applies even where the company may not have suffered a loss. Directors must not place themselves in a position where it appears that they are motivated by considerations other than those in the best interests of the company.

Undisclosed Profits

Directors in receipt of bribes or other undisclosed benefits are clearly in breach of their fiduciary duty to the company and the members, irrespective of whether or not the company has suffered a loss. Directors can be required to compensate the company for the personal benefit so derived.

Taking up a Commercial Opportunity

A director should avoid putting themselves in a position where they make a profit from taking up an opportunity which should have been taken up by the company. The director will then be liable to account to the company for the profit so derived.

However, in cases where the company was (or is) unable to take up the opportunity, the law is not so clear. Case law conflicts on the issue.

Generally speaking, a director may take up a corporate opportunity if full disclosure is made to other directors and preferably to the general meeting of members.

Use of Confidential Information

Directors cannot use for their own benefit confidential information or company property. Such information would include trade secrets, company member details, financial performance information and the like.

Improper use of information and position (insider trading)

Directors cannot make use of information acquired through their position in order to make a profit for themselves. This general duty is supplemented by sections 183 and 184 of the Corporations Act which prohibit an officer (defined to include director or employee) from making improper use of their position, or of information acquired by virtue of their position, to gain an advantage for themself or for any other person or to harm the company. Therefore, directors are prohibited from using information to make a profit for themselves or for anyone else by dealing in the company's shares where that information is not generally available to the public. This prohibition applies to all companies, whether listed on a stock exchange or not.

Specific Provisions of the Corporations Act 2001

The Act contains numerous specific sections which impose duties on directors. The more significant include the duty to ensure:

- various registers and minute books are properly kept, which include:
  - register of charges;
  - register of debentures;
- a meeting of members is called within 21 days of receiving a requisition in writing;
- the meeting is to be held no later than two months after the request is given to the company;
- reasonable steps are taken to ensure proper accounting records are kept;
- compliance with the provisions relating to directors' declarations and directors' reports to be attached to the annual financial statements;
- the company does not incur a debt when it is unable to pay its debts as and when they become due and payable;
- dividends are paid only out of profits; and
- directors are required to set out in an explanatory statement details of their interests in a compromise or arrangement with creditors.

Taxation and Revenue Laws

Directors are at risk under various provisions of Federal and State revenue laws. The risks associated with these laws include:

- potential personal liability; and
- prosecution (fine or imprisonment).

In broad terms the areas to watch out for include:

- Federal:
  - income tax (including PAYG);
  - customs and excise
  - fringe benefits tax (FBT);
  - superannuation guarantee; and
  - GST.

- State:
  - payroll tax;
  - stamp duty; and
  - WorkCover/workers' compensation.

Other Laws and Codes

The list of potential exposure is enormous and the list below is by no means exhaustive:

- trade practices;
- national consumer credit;
- employment law (work choices, equal opportunity, sexual harassment, occupational health and safety, industrial agreements, superannuation);
- criminal law (Crimes Act, Crimes Taxation Offences Act); and
- environmental laws (all States of Australia (except the Northern Territory and the Australian Capital Territory) have provisions to take criminal actions against directors).

Director's duties regarding financial statements and reports

A director has a duty to ensure that the credit union's financial statements have been prepared in accordance with the requirements of the Corporations Act and relevant Accounting Standards.

As a public company, the financial reports must be prepared within the earlier of 21 days prior to the AGM or 4 months after the end of the financial year. A copy of the financial reports must be lodged with ASIC within 4 months of the end of the financial year. Under the Financial Services Reform provisions of the *Corporations Act*, Financial Reports must be lodged with ASIC by an AFS licensee within 3 months of the end of the financial year.

Annual Statements

Annual statements were introduced on 1 July 2003 and replaced annual returns at the same time.

Annual statements contain the company's information as it appears on ASIC's database. If this information has changed, ASIC must be notified within 28 days of the review date (usually the anniversary of the company's registration date). The annual review fee shown on the statement must be paid within two months of the review date.

Company directors are also required to pass a solvency resolution within two months of the review date. Directors are assumed to have represented their company's solvency if they have:

- paid its review fee;
- not lodged a form 485 (Statement in Relation to Company Solvency) within two months and seven days after the company's review date; and
- not lodged a financial report in the previous 12 months.

Company Secretary

Overview

Under of the *Corporations Act* the company must have at least one secretary appointed by the Directors. At least one secretary must ordinarily reside in Australia. The *Corporations Act* sets out the eligibility requirements to be a secretary, certain duties of the secretary and the consequences for failing to perform those duties. The board may determine the terms of appointment, powers, duties and remuneration of the secretary.

Corporations Act Responsibilities

Under changes to the *Corporations Act* that commenced on 1 July 2003, company secretaries are responsible for contraventions of the following requirements:

- The requirement to correct inaccuracies in the company's Extract of Particulars.

- The requirement to lodge a Return of Particulars. This is a new requirement that arises in certain limited circumstances.

- The requirement to lodge the company's financial reports with ASIC within 4 months after the end of the financial year. The requirement to lodge financial reports with ASIC is not new but the imposition of direct responsibility on the company secretary is.

These responsibilities are set out in s 188, as amended by the *Corporations Legislation Amendment Act 2003* (Cth).

Contravention of these responsibilities by a company secretary after 1 July 2003 is a strict liability offence.

Existing responsibilities

Company secretaries are also reminded that under existing requirements in s 188, they are responsible for the contraventions of the following requirements:

- The requirement that the company must have a registered office

- The requirement to notify ASIC of a change in the address of the company's' registered office.

- The requirement to notify ASIC of a change to the company's registered office opening hours. Notice must be given in advance of the change.

- The requirement to notify ASIC when a director, alternate director or secretary is appointed.

- The requirement to notify ASIC of a change to the name or address of a director, alternate director or secretary.

- The requirement to notify ASIC when a person stops being a director, alternate director or secretary.

Contravention of these responsibilities by a company secretary is a strict liability offence.

Appointing a Secretary

The board must appoint the Secretary. The board may determine the terms of appointment, powers, duties and remuneration of the Secretary (note, you should refer to your Constitution for any provisions dealing with the appointment, remuneration and removal of the Secretary).

If the board fails to appoint a Secretary, ASIC will send each director a penalty notice and will prosecute directors who do not comply with the notice.

You must receive a consent to act as secretary from the person before appointing them secretary. The company must keep the consent.

3.4 Meetings

Types of Meetings

There are three types of meetings of a company.

- Board Meeting
- Annual General Meeting; and
- Special General Meeting

The *Corporations Act* imposes certain obligations on the directors with respect to these meetings such as the timing and frequency of the meetings; quorum; the giving of notice; the content of the meeting; voting rights; and the keeping of minutes.

Board Meeting

Overview

The Constitution and the *Corporations Act* govern the calling and conduct of board meetings.

Notice of Board Meeting

Section 248C (a replaceable rule) provides that a directors' meeting can be called by a director giving notice to each other director. Check your Constitution for the manner of giving notice.

How the Board Can Meet – Using Technology

Directors may conduct a board meeting by:

- meeting in person; or
- meeting using telecommunications technology such as conference calls or video conferences.

However, to use technology for a meeting, ***all directors*** must consent to the board meeting using such technology. A director may give a standing consent. A director may only withdraw their consent within a reasonable period before the meeting.

Conflicts of Interest

Subject to certain exceptions, a director of a company who has a material personal interest in a matter that relates to the company's affairs must not either:

- be present while the board considers the matter; or
- vote on the matter:

Where a director must not be present while the board considers a particular matter, you should make arrangements for the interested director to leave the meeting when the board starts considering the matter.

Quorum for Board Meetings — The Constitution

Section 248F (a Replaceable Rule) provides that the quorum for a Directors' meeting is 2, unless the Directors otherwise determine.

Your Constitution may provide differently. Typically, credit unions provide for a quorum consisting of:

- half the number of directors on the board at the time of the meeting; or
- such other number as the board determines.

The quorum must be present at all times during the meeting. Unless a quorum is present, a board meeting will be invalid and any resolutions passed at the board meeting will be ineffective. There can be an exception to this rule where the number of directors on the board is less than the quorum.

If a director must not be present while the board considers a particular matter because of a conflict of interest, the Board should ensure that enough directors will remain to constitute a quorum.

Circulating Resolutions

Section 248A of the *Corporations Act* (a Replaceable Rule) provides for circulating resolutions. Your Constitution can therefore govern whether the board may use a circulating resolution to pass resolutions and, if so, the requirements for the circulating resolution to be effective.

The *Corporations Act* Replaceable Rule provides that a circulating resolution can be passed if all the directors that are entitled to vote sign a document containing a statement that they are in favour of the resolution. Your Constitution can alter this requirement. You should check your Constitution for details of the requirements. If the Constitution is silent on the matter then the *Corporations Act* provisions will apply.

Conflicts of Interest

Subject to certain exceptions, a director of a credit union or building society who has a material personal interest in a matter that relates to the mutual ADI's affairs must not vote on the matter.

This rule applies to circulating resolutions as well as resolutions passed at board meetings. Unless an exception applies, a director who has a material personal interest in the matter the subject of a circulating resolution is ***not entitled to vote*** on the resolution. However, so long as the other directors sign the circulating resolution document, the circulating resolution will be passed.

When is the Circulating Resolution Passed?
Most Constitutions will provide that the circulating resolution is passed on the date that the last director signs the circulating resolution. You should check your Constitution to see if the provisions are any different.

Each director should date the circulating resolution as well as signing it, to enable the Secretary to determine when the resolution was passed. In order to determine whether the circulating resolution has been passed, the Secretary should confirm that each director has given the Secretary either:

- a signed and dated copy of the circulating resolution document; or
- a notice advising that the director has a material personal interest in the subject matter of the circulating resolution and a brief explanation of the nature of the material personal interest.

Minutes of Circulating Resolution
The company must maintain minutes of the circulating resolutions passed by the board. The company must prepare minutes of a circulating resolution within 1 month of the date the resolution is passed. The minutes must be kept in the company's minutes book. A director must sign the minutes of the circulating resolution within a reasonable time of the circulating resolution being passed.

General Meetings Called by the Board

Overview
Your Constitution governs when the board can call a general meeting of members. The *Corporations Act* sets out the procedure for calling a general meeting.

For most credit unions and building societies the Annual General Meeting, must be held at least once in each calendar year and within 5 months after the end of its financial year.

Corporations Regulation Part 12.4 allows a credit union or building society to give members a choice whether they require a Notice of Meeting to be sent to them.

Under most Constitutions, the board may call a general meeting at any time.

Notice Period for a General Meeting

The credit union or building society must give at least 21 days notice. Shorter notice may be given if members with at least 95% of the votes that may be cast at the general meeting agree to short notice before the general meeting.

You cannot give short notice of a general meeting if you intend to move any of the following resolutions at the general meeting:

- a resolution to remove a director from office;
- a resolution to appoint a new director to replace a former director removed from office by a resolution of the general meeting; or
- a resolution to remove a company auditor.

However, in view of the number of members who must give their consent (95%), the ability to call a general meeting on short notice is of little practical use to credit unions or building societies.

Board Resolution Calling the General Meeting

The board must pass a board resolution in which it:

- calls the meeting;
- determines the resolutions and special resolutions to be put before the general meeting; and
- instruct the secretary to give notice, including consent to short notice if required and permitted.

The board may pass the resolution:

- at a board meeting; or
- by a circulating board resolution.

Contents of Notice

The written notice of the general meeting must include the information required by section 249L of *Corporations Act*. It must include: -

- place, date and time of the meeting;
- if the meeting is to be held in 2 or more places, the technology to be used to conduct the meeting in this way;
- the general nature of the meeting's business;
- whether any special resolutions will be put before the general meeting, and the terms of those special resolutions; and
- in relation to proxies:
  - ⇒ that the member has a right to appoint a proxy;
  - ⇒ that a member who is entitled to cast 2 or more votes may appoint 2 proxies and may specify the proportion or number of votes each proxy is appointed to exercise.

The information included in the notice of meeting must be worded and presented in a clear, concise and effective manner.

As Public Companies, credit unions and building societies do not have the right to require that the proxy must also be a member. A member can appoint whomever they want as their proxy. Depending on the adoption of the Principles of Mutuality, credit unions will limit the right of members to vote more than once. If any member may be entitled to exercise more than one vote, then the Notice of Meeting must contain the information about the right to appoint more than one proxy.

Sending the Notice

You must give written notice to:

- all the members who are entitled to attend and vote at the general meeting (this may not be required if your credit union or building society has followed the "Opt-in" procedures and the member elects not to receive a Notice of Meeting), ;
- all the directors;
- the company auditor; and
- the company must also give the company's auditor all the documents that a member is entitled to receive in relation to the general meeting.

Opting to Receive Notices of Meeting - "Opt-in"

For most Corporations under the *Corporations Act* there is a positive obligation to give all members a notice of any general meeting of members. However, a concession has been extended to credit unions and building societies to allow them to give the members an option on whether they want to receive notices of certain general meetings or not.

The concession **does not** apply with respect to General Meetings called under Part 5 (External Administration - winding -up), Part 6 (Takeovers) or Part 5 of Schedule 4 (Demutualisations). It **does** apply to all other General Meetings.

General Meetings Required or Called by Members

The Board must convene a meeting if requested by:

- members with at least 5% of the votes that may be cast at a general meeting; or
- at least 100 members of the company who are entitled to vote.

Please Note that the Commonwealth Government is proposing to amend this "100 Member Rule" to remove the 100 member provision. However, at the time of preparing the Manual that amendment had not been agreed to by the States.

The members' request to call a meeting must:

- be in writing and signed by the members making the request; and
- state any resolution to be proposed at the meeting.

The board must send notice of the general meeting within 21 days of the request. The procedure for calling the general meeting is the same as the Board calling a general meeting on its own motion.

Notice of General Meeting

The company must give written notice of the general meeting to all the members entitled to attend and vote at the general meeting, the directors and the company auditor, **within 21 days of receiving the members' reques**t.

Failure to Call Meeting
If the board fails to call a meeting within 21 days of the request, members with at least 50% of the votes of all members who make the request will be able to call the meeting themselves.

Conducting General Meetings

The Constitution and the *Corporations Act* govern the holding of general meetings and voting at general meetings.

Questions and Comments by Members at AGMs

The chair of an AGM must allow a reasonable opportunity for members as a whole at the meeting to ask questions about or make comments on the management of the company.

Standing orders, if adopted, do not apply to a member exercising this right. If the company's auditor or their representative is at the meeting, the chair must allow a reasonable opportunity for members as a whole at the meeting to ask the auditor or their representative questions relevant to the conduct of the audit and the preparation and content of the auditor's report.

Voting By Proxies and Representatives of a Body Corporate

Under the *Corporations Act*, members have a right to appoint proxies to vote at general meetings. A member that is a body corporate has the right to appoint a representative. These are mandatory provisions of the *Corporations Act* that cannot be varied or replaced by the Constitution.

The critical times when a company has to consider proxies are:

- when issuing the notice calling a general meeting;
- voting at the general meeting

Form of Proxy
The board may determine the form of proxy from time-to-time (check the credit union's or building society's Constitution).

If a member requests a proxy appointment form or a proxy list, the company must send the same to all other members who request them. If the company sends a proxy appointment form or a proxy list to a member without being asked, the company must send the same to all members entitled to attend and vote at the meeting.

Valid Appointment of Proxy
Any member entitled to vote at a meeting can appoint a proxy to attend at the meeting. The person appointed as the member's proxy may be an individual or a body corporate. A body corporate that is a proxy would appoint a representative to exercise these powers. The company cannot require that the proxy also be a member.

An appointment of a proxy will be valid if it is signed by the appointing member and contains the following information:

- the member's name and address;
- your credit union or building society's name;
- the proxy's name or office;
- the meetings at which the proxy is to be used.

Rights of Proxies at General Meetings

Proxies have the same rights as the member for whom they are acting. Under section 249Y they can only vote to the extent allowed by the appointment.

The generally accepted rights and responsibilities of proxy holders are:

- they may attend one or more meetings designated by the appointer and any adjournments thereof;
- they may be counted in a quorum (section 249T)
- they may move and speak to a motion or to an amendment at the meeting;
- they may demand a poll, subject to the company's constitution and section 250L;
- where a poll is taken they may vote (in accordance with the terms of their appointment) unless the constitution provides otherwise; and
- generally appointed for a specific meeting or meetings

The proxy may only vote on a poll. There is authority that this right extends to voting on a ballot held at the general meeting (see Ryan v South Sydney Junior Rugby League Club Ltd (1974) 3 ACLC 486).. Therefore, on an election of directors at an AGM, a proxy is entitled to vote on the election.

The *Corporations Act* provides that, unless your Constitution specifically provides otherwise, the proxy's rights will be suspended if the member is present at the meeting.

An appointment of proxy may direct how the proxy must vote on a particular resolution. The proxy must vote as directed.

Body Corporate Representatives

A body corporate may appoint an individual as a representative to exercise the members' powers at a general meeting.

The appointment may be a standing one. The appointment may set out the restrictions on the representative's power. A body corporate member may appoint more than 1 representative but only 1 representative can exercise the member's powers at any one time.

Requirements for a Special Resolution

To pass a special resolution, you must:

- give at least 21 days notice of the meeting at which the proposed special resolution is to be considered:
- set out the terms of the special resolution in the notice as required for all meetings: and
- pass the resolution by a majority of not less than 75% of the votes that may be cast on the resolution:

3.5 Financial Reporting and Annual General Meetings

Financial Reporting and Audit

The *Corporations Act* governs:

- the financial reporting requirements;
- the auditing requirements;
- the annual general meeting requirements; and
- the requirement for lodging an annual return for your company.

Annual Reports Generally

The credit union must prepare and distribute financial reports and a directors' report for each financial year.

The financial reports consist of:

- the financial statements for the year;
- the notes to the financial statements; and
- the directors' declaration about the statements and notes.

Financial Statements and Notes

The financial statements consist of:

- Income Statements;
- Balance Sheets;
- Statement of Cash Flows for the year; and
- Statements of Change in Equity.
- If required by the accounting standards – consolidated Income Statement, Balance Sheet, Statement of Cash flows and Statement of Changes in Equity.

The financial statements must comply with the accounting standards. The relevant accounting standards are the standards of the Australian Accounting Standards Board.

The notes to financial statements must include:

- disclosures required by regulations;
- notes required by the accounting standards; and
- any other information necessary to give a true and fair view.

The financial statements and notes must give a true and fair view of the financial position and performance of the company. What is true and fair will depend on the commercial standards at that date. The board should approve the financial statements and notes to the financial statements before they are sent to members or lodged with ASIC.

Related Party Disclosure

The financial report of the company must comply with the accounting standards and must contain disclosures of all related party transactions. In particular, the financial report must disclose every financial transaction between the company and its directors.

The following information must be disclosed for each person who was a director of the company during the past financial year:

- income;
- loans outstanding and loans and repayments made;
- retirement and superannuation payments.

Specific information must be disclosed about every other financial transaction between the company and its directors. If the transaction is entered into on terms no more favourable than those offered to other customers or employees or the transactions are trivial or domestic in nature, a general description of the transaction is sufficient.

Directors' Declaration

The directors' declaration is a declaration by the directors:

- whether, in the director's opinion, there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable; and
- whether, in the director's opinion, the financial statement and notes are in accordance with the Corporations Act including section 296 (compliance with accounting standards) and section 297 (true and fair view).

The declaration must:

- be approved by or be made in accordance with a resolution of the board;
- specify the date on which it is made; and
- be signed by a director.

The board should only resolve to approve the contents of the directors' declaration and authorise a director to sign it once the board has:

- received and approved the final financial statements and notes;
- satisfied itself that the financial statements include information that became available since the end of the financial year which affect the determination of an amount in the financial statements; and
- satisfied itself that the company will be able to pay its current debts and future debts it is likely to incur in the future.

Directors' Report

The company must prepare a directors' report for each financial year

The directors' report must:

- be made in accordance with a resolution of directors;

- specify the date on which it is made; and
- be signed by a director.

The board must pass a resolution approving the content of the directors' report and authorising a director to sign and date it.

The directors' report for a financial year must:

- contain a review of operations during the year of the company and the results of those operations;
- give details of any significant changes in the company's state of affairs during the year;
- state the company's principal activities during the year and any significant changes in the nature of those activities during the year;
- give details of any matter or circumstance that has arisen since the end of the year that has significantly affected, or may significantly affect:
  - ⇒ the company's operations in future financial years; or
  - ⇒ the results of those operations in future financial years; or
  - ⇒ the company's state of affairs in future financial years; and
- refer to likely developments in the company's operations in future financial years and the expected results of those operations.

Auditors' Report

Your credit union or building society must have the financial report for the financial year audited and obtain an auditor's report.

The auditor has a right to access the books and to require any officer to give the auditor information, explanations or assistance reasonable for the purposes of the audit. An officer has a corresponding duty to allow the auditor to see the books and to give the auditor any information, explanation or assistance reasonably required.

If the auditor has reasonable grounds to suspect that the company has contravened the *Corporations Act* and that the contravention has not and will not be adequately dealt with by comments in the auditor's report or by bringing it to the attention of the board, then the auditor must notify ASIC of this. This includes any significant attempt, in relation to the audit, by any person to unduly influence, coerce, manipulate, mislead or otherwise interfere with the proper conduct of the audit.

The auditor's report must explain any extra information included that the auditor considers necessary to give a true and fair view of financial position and performance.

The company breaches the *Corporations Act* if it breaches an accounting standard prescribed by s 296 of the *Corporations Act*.

Annual Reporting Deadlines

The credit union or building society must:

- prepare the financial report, and directors' report;
- obtain the board's approval for the financial report and directors' report; and
- have the financial report audited and obtain an auditor's report for the financial year in time to satisfy the following deadlines:
  - ⇒ the deadline for sending the annual reports to all its members;
  - ⇒ the deadline for presenting the annual reports at the AGM; and
  - ⇒ the deadline for lodging the annual reports with ASIC.

Sending Annual Reports to Members

Unless the credit union or building society has adopted the "Opt-in" exceptions referred to below, it must send to all members:

- the financial report;
- the directors' report; and
- the auditor's report on the financial report.

The deadline for reporting to members is the earlier of:

- 21 days before the next AGM after the end of the financial year; or
- 4 months after the end of that financial year.

The company may choose to send to its members a concise report for the financial year instead of the reports listed above.

The company must send a full financial report, directors' report and auditor's report to any member that requests them. The company must send the reports to the member by the later of:

- 7 days after the request is received; or
- the deadline for sending the annual reports to members.

Under the *Corporations Act*, the company does not have to send the annual report or a concise report to any member who has requested the company not to send them any annual reports or concise reports.

The full or concise report can be sent electronically (if the member agrees) as follows:

- by sending it to the member by other electronic means (if any) nominated by the member; or
- by notifying the member through their nominated electronic means that notices of the meeting are available, and providing an electronic means for them to access the notice.

Consideration of Reports at AGM

The Board must lie before the AGM:

- the financial report;
- the directors' report; and
- the auditor's report;

for the last financial year ending before the AGM.

Lodging Annual Reports With ASIC

The credit union must lodge with ASIC:

- the financial reports for the financial year;
- the directors' report for the financial year;
- the auditor's report for the financial year; and
- if the company sends a concise report to its members – the concise report for the financial year;

  within 4 months after the end of the financial year.

You should also note that an Australian Financial Services Licensee must lodge a profit and loss statement and balance sheet with ASIC within 3 months of the end of the financial year (*s 989D* of the Corporations Act), though some credit unions and building societies can lodge within 4 months of the end of the financial year as ASIC has granted relief.

Holding the Annual General Meeting

Timing of AGM

The company must hold the AGM:

- at least once every calendar year; and
- within 5 months after the end of the financial year.

The company may apply to ASIC for an extension of time to hold the AGM. ASIC views AGMs as an important safeguard for shareholders, investors and creditors of a company. Extensions of time for holding an AGM will only be approved on good cause.

Annual Review

Annual review generally

ASIC must send the company an extract of particulars for the company within two weeks of the review date of the company. The company must return the extract of particulars to ASIC, noting any changes.

Solvency Resolution

The board must pass a resolution within two months after each review date for the company that, in their opinion, there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

The annual review includes a declaration that the board has passed this resolution. However, the board does not have to pass this resolution if the credit union has lodged a financial report with ASIC within 12 months before the annual review is lodged.

If the company has lodged a financial return within 12 months before lodging the annual review and the board does not pass a resolution about the solvency of the company within two months after the review date then the company must notify ASIC of that fact within 7 days after the end of the 2 month period following the review date.

Protection of whistleblowers

Part 9.4AAA of the Corporations Act provides protection for officers, employees, contractors (and their employees) with respect to disclosures made to:

- ASIC; or
- the company's auditor or a member of an audit team conducting an audit of the company; or
- a director, secretary or senior manager of the company; or
- a person authorised by the company to receive disclosures of that kind; and
    - (i) The discloser informs the person to whom the disclosure is made of the discloser's name before making the disclosure; and
    - (ii) The discloser has reasonable grounds to suspect that the information indicates that:
        - the company has, or may have, contravened a provision of the Corporations legislation; or
        - an officer or employee of the company has, or may have, contravened a provision of the Corporations legislation; and
    - (iii) The discloser makes the disclosure in good faith.

Any whistleblower (who follows the reporting requirements set out above) is protected from any criminal or civil actions as a consequence of making the disclosure. It does not protect the person with respect to conduct of that person. You should note that the protection includes the disclosure of information about matters that may have arisen before 1 July 2004.

If the person discloses information that qualifies for protection then the person to whom the information is given can only disclose the information or the identity of the person to:

- ASIC, APRA or the Federal police; or
- Another person with the consent of the whistleblower

You should ensure that your company has appropriate policies and procedures in place to comply with the whistleblower protection provisions. In particular, you should consider security arrangements with respect to information and identity.

3.6 Role of the Board

The Board lies at the heart of the modern corporation that is organised upon a separation of ownership and control whereby the Board monitors the management function in the best interests of the owners.

The role of the Board has been undergoing significant evolutionary change in recent times both in response to the increasingly complex legislative environment and in recognition that corporate performance must also be driven with the commensurate emphasis.

These issues in turn are the fundamental drivers behind the corporate governance debate that is now prominent in all discussions about good corporate practice.

Section 3.3 listed the duties of directors in terms of the Corporations Act which in effect outlines the *minimum standards* upon which directors carry out their duties working collectively as the Board. The Credit Union or Building Society Constitution will contain a division that establishes the Powers and Duties of the Board as: -

The Board:

a) manages the credit union or building society's business; and

b) may exercise all the powers of the credit union or building society except any powers that the Corporations Act or this Constitution expressly allocates to the general meeting.

c) To negotiate instruments on behalf of the credit union or building society.

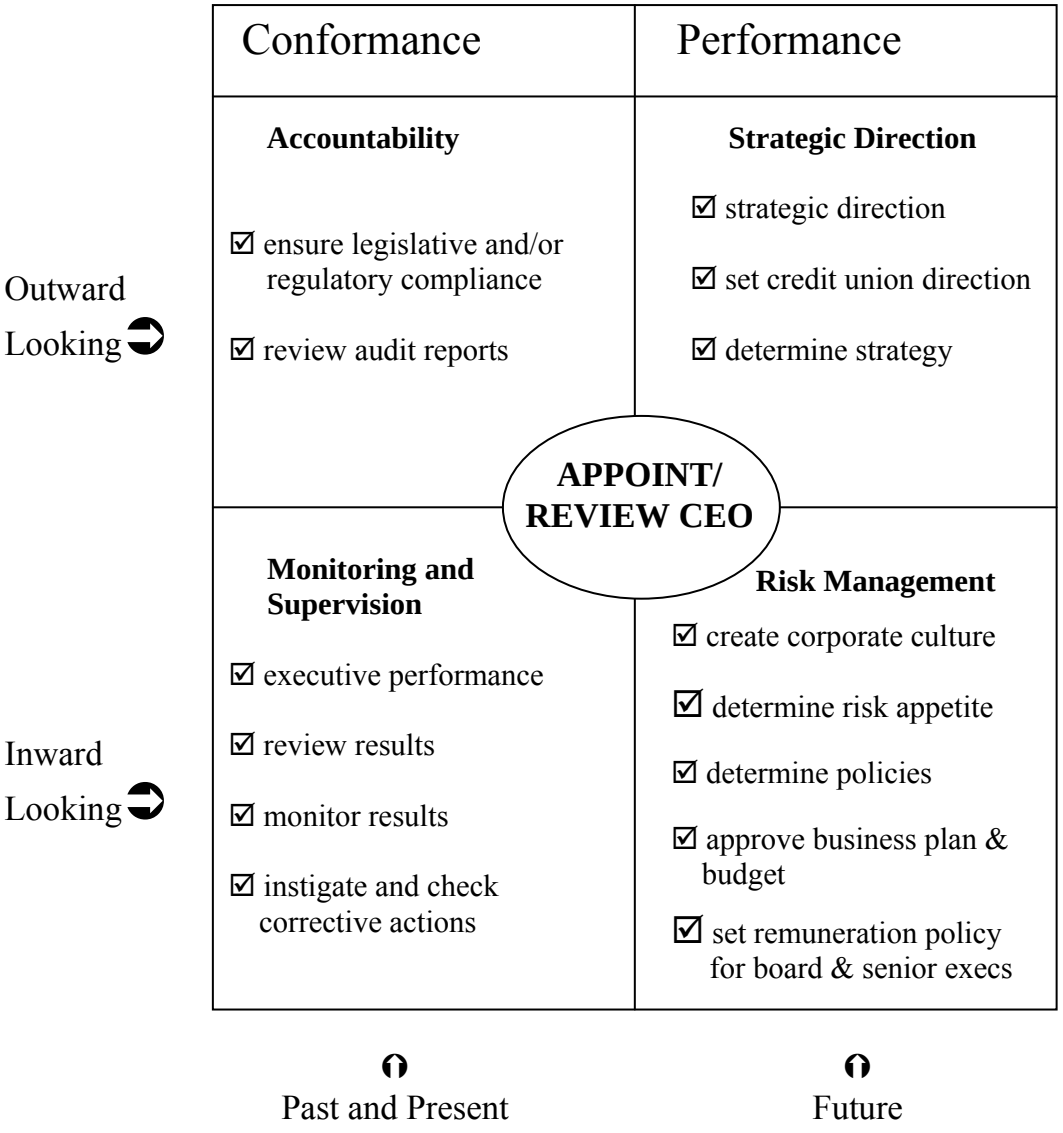
d) To delegate its powers to any committee or any other person or persons. The Board may permit the delegate to sub-delegate any powers delegated to them.

To assist Boards to develop a holistic appreciation of their role in the management of a credit union or building society AMInstitute has adopted the ***Tricker Model*** as a centrepiece for director education.

This model provides guidance to Boards about the full range of Board activities that are broadly arranged in the categories of conformance and performance.

However the overriding or principal responsibility above all else is to ensure that the best possible Chief Executive is in place to execute the agreed strategic plan and to manage the business opportunities and risks - and that this person continues to perform to the Board's expectations.

A Framework for a Credit Union or Building Society Board to Manage its Activities



Adapted from Tricker, R: *International Governance*

3.7 Role of The Chair

Despite the well-recognised fact that all directors on a board perform their role as equals, there is no doubting that the role of the Chair is critical to effective corporate governance. However, the Chair must view her or his role as a facilitator of the boardroom process as opposed to the *CEO of the Board*.

The chief concern for the Chair is ensuring that the board acts effectively and efficiently in its role as the ***mind*** of the organisation. He or she will oversee the development of the board agenda, undertake certain public relations responsibilities and act to ensure that board meetings run smoothly with a maximum debate but minimum conflict and time-wasting.

The Chair should play a key driving force behind the board and director performance evaluation processes that in turn links into director development programs and the priorities for board succession planning. The ongoing assessment by the Board about the skill mix within the Board (Board Composition) and the benefits of a Board Renewal Policy should be constantly assessed by the Chair.

But perhaps the most important role that a Chair plays is his or her relationship with the CEO. He or she is the major point of contact between the CEO and the board and is kept informed by the CEO on all matters that are of specific interest to directors. The relationship between the CEO and the Chair is one that underpins the entire management/board relationship and is critical to corporate governance success. The need for mutual respect and trust cannot be underestimated.

Some of the key responsibilities of the Chair of the Board would be (Note: These responsibilities are a guide and are subject to each Board's constitution, Charter/governance policies and approved delegations):-

- Ensuring that the Board participates in the setting of the strategic direction;
- Ensuring that the Board sets appropriate policies, accountabilities and limitations to guide management in the business operations;
- Ensuring the Board has access to timely information to undertake effective decision making and actions;
- Overseeing the administrative and reporting processes that support the Board in its meetings and other activities;
- Directing the board discussions to effectively use time to address the critical issues facing the organisation;
- Representing the Boards views in key governance arenas and public forums;
- Overseeing the effectiveness of the Board, Director and CEO performance assessment processes, playing a leading role in providing feedback and negotiating for Director and CEO professional development programs;
- Maintaining an ongoing and healthy relationship with the CEO.
- Overseeing the Board and Management succession planning policy.
- Ongoing assessment of Board Composition relative to the future direction of the organisation and the Board Renewal Policy.

3.8 Role of The Chief Executive

The Corporations Act, the Prudential Standards and the specific credit union or building society Constitution establish and specify the overriding powers and responsibilities for the Board to manage the credit union or building society.

Probably the most critical decision that the Board then takes is in the appointment of the appropriately qualified Chief Executive/General Manager in whom it entrusts the management of the credit union or building society through a system of Board approved policies and the *delegations of authority*.

The specific role of the Chief Executive can vary enormously depending upon the nature of the credit union or building society, its stage of development and the Board's attitude towards and preparedness to delegate authority. Notwithstanding these parameters the role of the Chief Executive will generally entail: -

- Management of the credit union or building society within the strategic plan and policy framework set by the Board including the approved allocation of resources (budget) and the delegation of authority.

- Development and maintenance of internal control and management reporting systems that keep the Board well informed about the credit union or building society's compliance with legislative standards and codes and performance in relation to agreed plans and objectives.

- Determination of an appropriate resourcing mix involving the management team, staff and outsourcing.

- Development of appropriate strategies to optimise resource utilisation in pursuit of agreed plans and objectives eg technology strategy, marketing plan.

- Provide leadership in the development of the management team, staff skills and career development and an appropriate culture for the credit union or building society blending the business imperatives with mutual philosophy, values and ethics.

- Consult regularly with the Board ensuring Board decisions are properly implemented and maintain strong, productive and honest relations with the Board and its Chair.

- Promote the credit union or building society's best interests in public forum and through the movement's governance processes in accordance with Board agreed objectives and strategies.

- Consult closely with the Chair in development of Board Meeting agendas, committee work, preparation of minutes and resolutions requiring approval.

3.9 The Role of Committees

Boards establish Board Committees to focus their attention on particular areas of risk and/or to carry out specific functions between Board Meetings. Such an approach can save considerable time at regular Board meetings, and often involves matching individual director's skills to key aspects of the Board's responsibilities and thus leads to better overall management of time and resources.

The three most common Board Committees are the Board Audit Committee, the Executive Committee and the Corporate Governance Committee. The Board Audit Committee was actually a mandatory requirement under the previous Financial Institutions Code and so all credit unions and building societies have had this Committee since 1992. Whilst no longer mandatory under the Corporations Act or company Constitutions it can be expected that credit unions and building societies will continue to utilise the Board Audit Committee given its demonstrated benefit in the area of compliance and risk management and its stature these days as an essential component of good corporate governance.

APRA, from 1st October 2006 has now mandated Board Audit Committees in all ADIs through implementation of APS 510 – Governance.

Board Audit Committee – Composition, Function and Objectives

This Committee should comprise a majority of non-executive Directors to which has been assigned, amongst other functions, the oversight of the financial reporting and auditing process and formulation, periodic review of the disaster recovery plan and assessment of the auditing functions.

The main objectives of an appropriately established and effective Audit Committee include enhancing the credibility and objectivity of financial reporting and assisting the Board to discharge its responsibilities.

This Committee will report regularly to the Board on developments and findings and make recommendations on specific courses of action deemed necessary. A list of suggested duties and responsibilities is set out below.

Duties and Responsibilities

* recommend to the Board the appointment of the external auditor;

* review the audit plans of the external and internal auditors;

* evaluate the effectiveness of both through regular meetings;

* determine that no management restrictions are imposed;

* evaluate the adequacy and effectiveness of administrative, operating and accounting policies through active communication with management and auditors;

* evaluate the adequacy of accounting control systems by reviewing formal reports from internal and external auditors;
* review financial reports to be issued to the public prior to release;

* review any regulatory reports submitted to the credit union or building society and monitor management's response to them;

* evaluate the credit union's exposure to fraud;

* receive any reports from the credit union or building society's legal advisers;

* monitor the standard of corporate conduct in areas such as arms length dealings and likely conflicts of interest;

* seek reports from management and auditors on any significant regulatory, accounting or reporting development and assess the potential impact;

* review and approve all significant accounting policy changes;

* review the annual financial statements with management and auditors and make recommendations to the Board;

* identify and direct any reviews or investigations deemed necessary;

- prepare a report to the Board summarising the work performed by the Committee to fully discharge its duties during the year.

- Review the Disaster Recovery Plan and ensure it remains a workable and effective document.

Whilst the final version of APS 510 – Governance did not prescribe financial expertise for at least one member of the Board Audit Committee the regulator has strongly suggested that this be incorporated in the makeup of Board Audit Committees for ADIs.

Other Committees

The Executive Committee usually has specific delegations to facilitate decision making between Board Meetings where such decisions are important to the business operations. The need for this function tends to arise more often in smaller to medium credit unions that still retain at Board level full authority in certain areas of operational decision making eg. interest rates, capital expenditure.

Other key areas of Executive Committee focus might be: -

- Managing and organising the Board's involvement in the strategic planning process.
- Conducting the Chief Executive performance and remuneration reviews.
- Facilitating the Board performance review and recommendation to members at the AGM about director remuneration.
- Board policy on director training, education and on-going professional development.
- Director succession planning.
- Managing the Board timetable, meeting agenda and work schedule.

Other Board Committees that are common in credit unions and building societies include:-

- Risk Management Committee
- Corporate Governance Committee
- Board & CEO Remuneration Committee
- Board Nomination Committee
- Compliance Committee
- Planning Committee
- Marketing Committee
- Committees set up for a specific purpose e.g. Building Committee.

For the medium and larger credit unions they have mostly eliminated the role of the Executive Committee, delegated some of the functions to management and allocated the remaining matters to the Corporate Governance Committee.

Board Remuneration Committee

An ADI must establish a Board Remuneration Committee consisting of at least three members all of which must be non-executive directors with the majority also independent including the Chairman with a written charter and terms of reference.

Committee responsibilities must include:

(a) conducting regular reviews of, and making recommendations to the Board on, the Remuneration Policy including an assessment of the Policy's effectiveness and compliance with the requirements of this Prudential Standard;

(b) making annual recommendations to the Board on the remuneration of the Chief Executive Officer (CEO), direct reports of the CEO, other persons whose activities may in the Board Remuneration Committee's opinion affect the financial soundness of the institution, and any other person specified by APRA; and

(c) making annual recommendations to the Board on the remuneration of the categories of persons covered by the Remuneration Policy.

The Board Remuneration Committee must:

(a) have free and unfettered access to risk and financial control personnel and other parties (internal and external) in carrying out its duties; and

(b) if choosing to engage third-party experts, have power to do so in a manner that ensures that the engagement, including any advice received, is independent.

Members of the Board Remuneration Committee must be available to meet with APRA on request.

3.10 Meeting Procedures

The following brief notes are intended to provide a basic insight into Meeting Procedures. A more comprehensive perception can be gleaned by the study of such accepted authorities as Joske's *Law and Procedure at Meetings in Australia* or N.E. Renton's *Guide for Meetings and Organisations*.

Before the Board or Committee Meeting

Some of the preparatory tasks include –

- Preparation of Agenda
- Booking of Meeting Rooms
- Circulation of Notice of Meeting together with Agenda and supporting papers in good time to allow proper preparation by Directors.

These tasks are invariably carried out by the Company Secretary but in close liaison with the Chair.

In preparing for the Meeting, the Chair should familiarise himself/herself with all correspondence and items to be discussed and should check for accuracy the minutes of the previous meeting being submitted for confirmation.

If there are matters arising from the previous meeting, the Chair should check on how these items are being dealt with on the Agenda.

Some estimate should also be made of the time needed to consider various Agenda items and a tentative time-plan noted on his/her copy of the Agenda. The Chair will use this as a guide when allowing time for discussion during the Meeting, thus ensuring that it progresses in an orderly and effective fashion and deals with the business before it.

Duties of the Chair

These include: –

- Chairing the Meeting including opening proceedings when a quorum is present after the scheduled starting time checking with directors as to whether they have any conflicts of interest to inform the Board of in relation to matters on the agenda and the closing the Meeting when all business on the Agenda has been dealt with;
- Maintaining order, allowing those Directors who have a valid contribution to make to speak without interruption;
- Being familiar with those provisions in the Credit Union's or Building Society's Constitution relating to meetings;

- Knowing and applying fairly the Rules of meeting procedures;
- Offering constructive guidance when required and encouraging the participation of all Directors;
- Keeping deliberations to the point at issue and discouraging irrelevant, aimless discussion.

Order Of Business

The order of business at Board meetings is generally as follows, although the Board may decide that an important item of business may be brought forward for early discussion.

[I] Apologies and leave of absence, Declarations of any Conflict of Interest

[ii] Confirmation of Minutes of previous meeting;

[iii] Any business arising out of the minutes;

[iv] Correspondence – the Chairperson or Chief Executive will refer to any correspondence and comment as appropriate;

[v] Various reports including the financial reports and KPIs and submissions from Chief Executive and Committees;

[vi] General Business – any matter not otherwise dealt with will be considered here.

[vii] Closure – after thanking members for their attendance and notifying the date, time and place of the next meeting, the Chair should close the meeting, noting the time.

Editor's Note: Given the weight and complexity of issues arising in the agenda of the modern credit union or building society many have now restructured their meeting agendas to ensure that the special business items (those resolutions being submitted by management and requiring a decision at the meeting) are moved up the agenda before correspondence and reports.

Motions

All motions (and amendments) need to be seconded before being debated. This should occur immediately the motion has been read or stated and before the mover speaks in favour of it. If a seconder is not forthcoming then it automatically lapses and the meeting should move to the next item of business.

Except in the case of a procedural motion (ie. one dealing with the conduct of the meeting itself) no motion may be proposed that is the same in substance as a motion already proposed and defeated at the meeting.

Procedural motions take precedence over any substantive motion.

Examples of procedural motions are:-

- That a person should/should not be heard;

- That strict order of debate be followed;
- That the motion be put or not put.
- That the meeting be adjourned;

Foreshadowing

If a member wishes to put a motion before the meeting but in a different form to that which is before the meeting, that member may oppose the motion and in so doing foreshadow another motion which is read to the meeting.

If the original motion is ultimately lost the foreshadowed motion may then be moved.

If however the original motion is carried then the foreshadowed motion lapses.

Amendments

An amendment should only be accepted by the Chair if it is relevant to the original motion, is serious and does not oppose the intention of the original motion. It should be noted that a direct negative is not an amendment eg. if the motion before the meeting is *that the report be accepted* an amendment *that the report NOT be accepted* is inappropriate.

The proper course in such circumstances for a member who wishes to have the report rejected is to speak and vote against the motion.

Point Of Order

A point of order may be taken at any time during discussion and pending a ruling by the Chair, debate is suspended.

A point of order shall show that the speaker was: –

- Using unseemly language;

- Not addressing the question; or

- Infringing upon the Credit Union or Building Society Constitution.

Any of the Standing Orders, may be suspended upon the affirmative resolution "***that so much of standing orders be suspended as would….”***, the latter part of the motion expressing the purpose of the suspension. The motion is carried or lost by a simple majority.

Debate

A member wishing to speak, shall address the Chair.

When two or more Directors wish to speak, the Chair shall call upon the Director whom he/she believes first indicated such intention. No Director shall speak to any motion after it has been put.

A Director shall not speak more than once to any motion without the permission of the Chair.

Voting

All matters shall be decided by a vote of a majority of those present at the meeting and eligible to vote.

Voting is normally *on the voices* unless there is doubt and, in this event, the Chair of his own volition asks for *a show of hands* or this action is requested and supported from the floor.

Occasionally, it will be necessary for a matter to be decided by a poll [ie. a recording of votes by writing].

Dissent from Chair's Ruling

If a director believes a ruling by the Chair is incorrect and the circumstances are such that this needs to be formally reversed, he/she should rise and say *I challenge your ruling*.

At this stage, the Chair vacates the chair and a Deputy or someone elected by the meeting takes the chair.

The Deputy invites the person dissenting to state the reasons for the challenge.

After he/she has done so, the Chair offers his/her reasons for the ruling.

Both speakers should refer to the relevant rules and their particular interpretation.

No others may speak.

Non-Attendance

Any Director who is unable to attend the Board/Committee should tender his/her apology through the Company Secretary prior to the Meeting so that leave of absence can be granted.

Ideally, if a Director attending a meeting of the Board/Committee is aware that he/she will be absent at a subsequent meeting, leave should be sought at that time.

The Constitution of most Credit Unions and Building Societies will set out the appropriate procedures to be followed in respect of Notices to Members in respect of meetings. In most cases, they will also cover procedural guidelines to be observed at general meetings. It is recommended that directors familiarise themselves with these.

Minutes

The minutes of a meeting are the official record of the actions and decisions of the board or board committee. They are an important legal document and the preparation and approval (that they are complete and accurate) should be managed by each director as a matter of high importance.

The James Hardie Industries board now knows too well about the importance of minutes as a legal document. The case of *Australian Securities and Investments Commission v Macdonald* (No 11) [2009] NSWSC 287 (**ASIC** v **Macdonald**) decided in the New South Wales Supreme Court, highlights the importance of strict adherence to the requirements of the *Corporations Act 2001* (Cth) when preparing minutes of Directors' meetings (**Board Meetings**) in order for them to be relied upon as evidence.

The *Corporations Act 2001* (Cth), Section 251A(1)(b) provides that a company must keep proceedings and resolutions of Directors' meetings and record them in its minute book within 1 month of the meeting. Section 251A(2) provides that these minutes must be signed by the chair of the meeting or the chair of the next meeting. If these criteria are met, then Section 251A(6) provides that the minutes that are so recorded and signed are evidence of the proceeding, resolution or declaration to which it relates, unless the contrary is proven.

Minutes are now considered to include an expanded evidentiary requirement for the content and format of minutes to act as an enabling mechanism for Directors to establish that they had indeed discharged their duty and acted properly. This may include some indication of any substantial discussion, if that was the case, or papers and material referred to or relied upon.
The simple form of minutes recording adopted by many credit unions may need to be carefully reconsidered.

The format and content of the Board and committee meeting minutes are a decision of the Board and this is typically dealt with in the Board Charter or Board Governance Policies. Each Board also needs to have determined:

a) Appointment of a minutes secretary
b) Recording of minutes eg. use of audio recording
c) Preparation and review of draft prior to circulation to directors
d) Recording Motions or Resolutions
e) Requests to record a director's
f) Recording, or not, of the mover and seconder of a motion
g) Approval, signing: who, by when
h) Distribution and storage of minutes
i) Management of attachments

An example of the detail that may be provided is as follows:

> ***RESOLUTIONS***
>
> *Resolution numbers should be continuous from Resolution 1 at the beginning of every year. The word "Resolved" and the number should be typed in capitals and bold, flush with the left margin. The text of the resolution should be typed flush with the left margin underneath the resolution number, see below:*
>
> ***RESOLVED – 10***
>
> *That the minutes of the meeting of the credit union's Board held on 10 April 2009 be confirmed.*
>
> *An example of quoting resolutions numbers is to quote the number and then the year. See below:*
>
> *Resolution 35 of the year 2009 would be* ***R35/09****.*

As a guide the minimum content of minutes should be:

i. name of the credit union/building society and the body that is meeting (eg. ABC Credit Union, Board Nominations Committee,);

ii. date, place, opening and closing time and type of the meeting;

iii. name of chair of the meeting;

iv. record of those present or reference to a separate attendance register;

v. any declaration of conflict of interest;

vi. confirmation of previous minutes;

vii. record of all topics discussed , the nature and substance of the discussion (note (1) refer to example below);

viii. record of any motions, resolutions and amendments and their fate (passed, rejected, lapsed or adjourned etc);

ix. record of approval or ratify all the credit union's or building society's financial reports;

x. procedural motions such as adjournments, personal explanations;

xi. signature of chairperson of the meeting.

Note (1). Example of recording a topic discussed and resolved

5.2 Purchase of replacement Prepatator: The CEO referred to his report included in the Board papers and tabled a revised costing, dated 14/4/09. The board after noting the detailed background material provided by management, accepted the need for a new Prepatator however debated at length the proposed timing of the purchase and the payment terms .

Resolution: That the replacement Prepatator, model A17, be purchased next financial year, no later than September, subject to the supplier retaining the current price.

3.11 Board & Management Relations

The Board is predominantly a policy making body with the individuals who serve on it, elected by members.

The Chief Executive, on the other hand, is appointed by the Board and employed by the Credit Union or Building Society. He/she is responsible for implementation of the Board's policy and staff resources are deployed by the Chief Executive, in liaison with line Managers/Supervisors, to achieve this.

It is essential that the Board has confidence in its Chief Executive and that it provides an environment of support and freedom to do the job. At the same time, the Chief Executive has to be confident that the Board will fulfil its responsibilities.

Board and Chief Executive share the task of ensuring the ongoing viability and successful operation of the Credit Union or Building Society and it will be recognised that this can best be achieved if they work together as a team.

Arising out of this, the development of a harmonious working relationship is critical and the Board, as the supreme decision maker, should take the lead in establishing and maintaining such a relationship.

In so far as the Chief Executive translates the Board's directives into action, performance should be closely monitored.

Ideally, both Chief Executive and Board Members should evaluate individual performance and that of the Credit Union or Building Society against standards and goals. Irrespective of the particular standards selected, the means of measurement should be specific, written in terms of outcome, realistic and clearly stated.

Accountability should be the logical aim and end.

Frank and open communication both ways is most desirable and if performance is below expectations or there is continuing difficulty in some area, the Board should bring the matter to the Chief Executive's attention and explore possible ways to remedy the situation.

Conversely, if the Chief Executive disagrees with a Board viewpoint, he/she has a responsibility to speak out and *tell it as it is*. The Board, for its part, should welcome and encourage such comment. However, if the Board still holds its ground notwithstanding, then the Chief Executive should accept the situation.

Care needs to be taken not to undermine the Chief Executive's authority, and in this context, it is important that any communication concerning a particular problem or difficulty be channelled through the Chief Executive **[i.e. individual**

Board members should not deal directly with nor issue directions concerning such matters to other staff]. It may be appropriate for directors to deal with managers or staff for procedural matters, especially when connected to committee work that involves the manager/staff member. It is also important for directors to have a working relationship with other key managers and staff for risk management purposes.

While it is desirable for the Board to maintain a good harmonious working relationship with the Chief Executive, there will be occasions when differences arise and it needs to be understood that this is inevitable.

It is important that both sides recognise conflict as a necessary element in exploring options and that they harness the inherent dynamics to arrive at a constructive outcome. The focus should be on finding a solution to the problem rather than on personalities involved.

When differences occur, it is a case on both sides, of arguing for the merits of their respective viewpoints in a coherent, concise and courteous way ensuring along the way that the difference not be allowed to mar the working relationship.

As a Credit Union or Building Society grows, it eventually reaches a stage when the Board must rely heavily on the Chief Executive's integrity and expertise to ensure that all is well. Notwithstanding the best of intentions, a Board can be caught in a *no win* situation and there might well be some perception that it is being held *hostage* by management.

There are clear dangers in such situations and Directors need to guard against implicit trust or accepting without question everything their Chief Executive says or does [the halo effect].

It is essential that reports and recommendations be closely scrutinised on an ongoing basis. Whenever there is doubt, management should be queried and asked to explain.

One question that always arises in respect to Board/management relations is ***how close do you get?*** Do you hold the Chief Executive at arm's length or alternatively ***get close, in a warm friendly relationship?***

There is no substantiative answer! It depends on circumstances and the individuals concerned. However, there are dangers in extremes at both ends for example, in the arms length environment, the Chief Executive may feel that he/she is not fully trusted, that they do not have the Board's confidence - while in the other extreme, the closeness of the relationship may distort individual judgement or lead to development of a trust that is misplaced.

The prudent course would seem to lie somewhere in between ... not too aloof, not too close!

A final word! Staff at all levels will appreciate your tangible interest and support and will respond enthusiastically to your encouragement. Don't forget to let staff

members know [through their Chief Executive] that you recognise their achievements when this is appropriate.

3.12 Board & CEO Performance Assessment

Assessment of the performance of corporate enterprises, including credit unions, and building societies has been the focus of business discussion for more than a decade. The reasons are many, the methods being used to undertake performance reviews are varied, but there is now acceptance of the view that the performance of an enterprise is enhanced when its Board, Directors, and Chief Executive Officer, are regularly and rigorously reviewed.

The task is made more difficult as the role of Boards is an evolving one, with the emphasis now moving from conformance to performance, some lack of clarity about the criteria to be measured, the sensitivities involved in assessing the performance of peers, and how to handle the results of performance assessments.

Nonetheless credit unions have explored ways and means of assessment for a number of years with many credit unions operating successful and sophisticated appraisal systems with resultant improved overall performance.

While each credit union and building society will approach assessment from a differing perspective, generally there are five key areas for determining the performance of a Board:-

- strategic direction and implementation
- monitoring financial and non financial performance
- board development, evaluation and succession
- monitoring the legal and ethical performance of the credit union; and
- risk and compliance management including crisis management.

Initial assessment approaches work more successfully when the number of areas to be evaluated does not exceed seven and the criteria used include both qualitative and quantitative measures.

Whatever the methods determined for assessing Board performance, it is best undertaken against a background of a commitment to review past performance with an emphasis on future development. There is now sufficient information available for Directors to make judgements about their own Boards in terms of good practice applying in comparable organisations.

Assessment of Directors is a more difficult aspect. For credit unions the concept of assessment has a further challenge. Directors are elected for a term of office by the members. They have not traditionally been elected and retained subject to performance. Performance assessment has therefore been used by a Board to improve each Director's awareness of their role, their strengths and weaknesses as a Director, how they compare with their peers, and what the Board overall considers important.

However expectations are changing rapidly with director performance moving more squarely into the limelight. One impetus for this has been the changes to the Banking Act in November 2003 and the consequential new prudential standards APS 510 – Governance and APS 520 - Fit & Proper both implemented from 1st October 2006.

Initially Director assessment tends to focus on areas common to all Directors.

Examples are:-

- an understanding of roles and professional responsibilities;
- range of skills and knowledge required;
- ability to contribute to the planning and strategy of the mutual ADI; and
- understanding about the application of risk management techniques to the business of an ADI.
- identified areas for improvement.

As with Board assessment the methods are varied and appropriate to the culture existing in the credit union or building society. Normal methods include self assessment, peer assessment, Chair's evaluation, outside independent assessment. Some methods involve a qualitative rating system, or a numerical grading system, and usually with provision for comments.

Importantly with Director assessment there needs to be a clear understanding and commitment that the process is designed to ensure development of the Director's capacity to contribute to the workings of the Board.

The development and refinement of Board / Director / Chair Performance Assessment systems in recent years has led to a demand for specific standards that can be used to measure against. A set of nationally agreed corporate governance standards were developed for this purpose through a Steering Committee facilitated by the National Finance Industry Training Advisory Board (NFITAB) along with the personal competencies for directors required for a Board to meet these standards. AMInstitute with the support of FSEAA (nee NFITAB) have provided these standards to some 30 credit unions between 2004 and 2006.

The Chief Executive Officer has a pivotal role in advancing the credit union or building society and assessment of the performance of the incumbent is crucial. Most mutual ADIs have some procedures for doing so. However many credit unions and building societies are reviewing the practices currently in place to provide an enlarged spread of criteria by which the Chief Executive Officer might be judged and, in some cases, to avoid confusion in equating performance assessment with salary review.

There is a range of methods for assessing a CEO but as with Director assessment, it is critical to the process to have agreement between the Board and the CEO about the criteria to be used. Most sensibly, criteria need to be objective, utilising both financial and non financial measures of performance, setting achievement targets, and appropriate methods of monitoring performance against the agreed goals.

Performance assessment is an ongoing process that varies among mutual ADIs, according to size, functions, level of activity, and range of director skills. Those credit unions or building societies that are committed to it recognise the importance of regularly reviewing the whole process involved.

3.13 Board Composition, Succession Planning & Induction

Board Composition issues have taken on a much greater level of importance for credit union boards in recent years as the business and regulatory environment for ADI's becomes increasingly complex and competitive.

Credit Union and Building Society Boards are seeking the right mix of skills on the Board to provide the strategic direction and risk management policy framework commensurate with their mutual ADI's positioning in the marketplace.

There is now a greater inclination to embrace succession planning techniques to identify new directors with particular skills to supplement the mix of skills available on the Board. This trend involves establishment of Board Nomination Committees and policies that support concepts such as the ***Associate Director*** or ***Director in Training***.

Such developments are also leading to an increased commitment to training and professional development of directors to grow the skills within the Board. This has led AICUD (now AMInstitute) to offer since 2001 the ***Mutual ADI Directors' Diploma Course*** based on national competency standards in the financial services business for credit union and building society directors.

After an extensive consultation period commencing in September 2001 together with the amendments to the Banking Act in November 2003 which introduced the *fit and proper* test for directors, senior managers and auditors APRA finalised in 2006 two new prudential standards to establish new mandatory standards for mutual ADIs.

APS – 510 Governance sets a range of governance standards for Boards covering Board Composition, Board Renewal and Board Performance while ***APS 520 Fit and Proper*** sets standards for fitness and propriety of individual directors, managers and auditors.

All of these developments and pressures place increasing importance upon establishing on effective ***Director Induction*** process within credit unions and building societies to support the new director in scaling a significant learning curve within the shortest possible timeframe.

Larkin and Kaye Consulting Services have kindly provided two of their tools which may assist boards in responding to the challenges in ***Board Composition*** and ***Director Induction*** respectively. These tools can be found in annexures to this booklet: -

Annexure A – Board Composition & Succession Planning
B – Sample Credit Union Ltd – New Directors Induction Program

3.14 Fitness of Directors, Officers & Auditors

Fitness of Directors, Officers & Auditors

The Senate passed a Bill in November 2003 to amend the Banking Act (the Financial Sector Legislation Amendment Bill (No. 2) 2002).

The Bill made a range of amendments to the Banking Act. Including: -

- *"fit and proper" test*: for directors and senior managers of ADIs, under prudential standards.
- *Power to remove auditors of ADIs who fail to perform adequately:* a "fit and proper" test to ADI auditors.
- *ADI reporting requirements:* a statutory obligation for an ADI to notify APRA of any breaches of Prudential Standards or licensing conditions and any material changes.

***Commencement of the 'disqualified persons' categories*:** As part of the fit and proper regime (most of which was implemented by prudential standards) the Bill created an offence for an ADI to employ a 'senior manager' (someone performing senior manager functions) or have as a director a 'disqualified person'.

The categories for disqualified person are wide, and include having any previous dishonesty offences, bankruptcy or bankruptcy relief, breaches of the Banking Act or Corporations Act, amongst other categories. ADIs are able to apply to APRA to have a person declared not to be 'disqualified'.

Application of the propriety aspects via the disqualified persons' provisions commenced from February 2004 whilst the fitness aspects were placed on hold until the finalisation of the prudential standards in 2006.

A disqualified person commits an offence if the person is or acts as:

- a director or senior manager of an ADI (other than a foreign ADI); or
- a senior manager of the Australian operations of a foreign ADI; or
- a director or senior manager of an authorised NOHC.

A body corporate commits an offence if it allows a disqualified person to be or act as:

- if the body corporate is an ADI (other than a foreign ADI)a director or senior manager of the ADI; or
- if the body corporate is a foreign ADI senior manager of the Australian operations of the ADI; (c) if the body corporate is an authorised NOHC a director or senior manager of the NOHC.

A person is a ***disqualified person*** if, at any time

(a) the person has been convicted of an offence against or arising out of:

(i) this Act; or

(ii) the *Financial Sector (Collection of Data) Act 2001*; or

(iii) the *Corporations Act 2001*, the Corporations Law that was previously in force, or any law of a foreign country that corresponds to that Act or to that Corporations Law; or

(b) the person has been convicted of an offence against or arising out of a law in force in Australia, or the law of a foreign country, where the offence related or relates to dishonest conduct, or to conduct relating to a company that carries on business in the financial sector; or

(c) the person has been or becomes bankrupt; or

(d) the person has applied to take the benefit of a law for the relief of bankrupt or insolvent debtors; (e) the person has compounded with his or her creditors; or

(f) APRA has disqualified the person under section 21; or

(g) the person has been disqualified under the law of a foreign country from managing, or taking part in the management of, an entity that carries on the business of banking or insurance or otherwise deals in financial matters.

Largely these changes to the Banking Act focused on the *propriety* aspects whilst the fitness aspects were held over until finalisation of the prudential standard ***APS 520 Fit & Proper*** which became operative from 1st October 2006.

Fitness and propriety of responsible persons

APS 520 requires all ADIs to have a policy on fitness and propriety with respect to responsible persons. The term "responsible person" includes:

- Directors
- Senior managers. That term is defined in the Standard to mean, amongst other things, a person who makes, or participates in making, decisions that affect the whole or a substantial part of the business of the ADI and has the capacity to significantly affect the standing of the ADI.
- An auditor
- A person who performs activities for a subsidiary of the ADI where those activities may materially affect the whole or a substantial part of the business of the ADI or its financial standing whether directly or indirectly.

It must be appreciated that the Standard does not require the person to be an employee. A contractor or consultant may be a responsible person.

Fit and proper criteria

The competencies required by each responsible person must be documented.

That necessarily requires the ADI to establish clear terms of engagement and employment contracts for every relevant employee. Further, the competencies required of directors should be clearly documented in the Fit and Proper Policy and it is suggested that the requirement to meet the criteria is a qualification for election or appointment as a director under the terms of the Constitution.

Similarly, the competencies required of the auditor and of third parties who fall within the definition of "responsible person" should be set out not only in the Policy but also in the contract of engagement.

The fit and proper criteria that must be met are set out in the Standard:

- **Criterion 1**
  Whether it would be prudent to conclude that the responsible person possesses the **competence, character, diligence, honesty, integrity and judgement** to perform properly the duties of the responsible person.

The difficulty for all mutual ADIs is determining objective criteria for directors. For example, an issue for all mutual ADIs is determining whether to impose minimum educational criteria as the basis for establishing the competence of directors or candidates for election. It may be more appropriate to require that candidates for election must demonstrate a willingness to obtain appropriate training, such as the **AMInstitute Mutual ADI Directors' Diploma Course** or similar director training. It will be appreciated that APS 510 looks at the collective skills of the board in terms of governance and it may not be appropriate to establish inflexible criteria with respect to director competence.

An important aspect of determining fitness and propriety of candidates for election as directors is the implementation of a nominations committee process under the terms of the Constitution. There are a variety of approaches that mutual ADIs have taken in this regard. In some cases, the determination that a nominee for election (including incumbent directors seeking re-election) is not fit and proper will mean that the nominee's name will not be put forward to the members as a candidate.

In other cases, the members are simply advised that a candidate has not been found to be fit and proper. In this case, the failure to be found to be fit and proper on the basis of competence does not mean that the candidate is a "disqualified person" and, therefore, automatically disqualified from being appointed. It will be APRA's decision under section 23 of the Banking Act whether it will take the critical step of directing the ADI to remove the director from office.

- **Criterion 2**
  A person is not fit and proper if they are a "disqualified person".

- **Criterion 3**
  There must be no conflict of interest or, if there is a conflict of interest it would

be prudent to conclude that it will not create a material risk that the person will fail to perform properly the duties of the position

This criterion is consistent with the obligations of all directors to avoid conflicts of interest. Each mutual ADI will have to determine what sort of conflicts are or are not acceptable. For example it may be acceptable for a professional adviser to become a director but not a person who is a director of a competitor.

Additional requirements for Auditors
In addition to the above criteria, the auditor must also:

- Be registered as an auditor under the Corporations Act;
- Ordinarily reside in Australia;
- Be a member of a recognised professional body; and
- Have a minimum of 5 years relevant experience in auditing ADIs and it would be prudent to conclude that the person is familiar with the current issues in the audit of ADIs.

Fit & Proper Rules in Respect of New Zealand Credit Unions

As per the regulations (expected December 2010) in regards to the Reserve Bank of New Zealand Amendment Act (No 3) 2008, Directors and Senior Executives will be required to meet the Fit and Proper Person requirements of:

- Honesty, Reputation, and Integrity
- Financial Soundness
- Competence and Capability

The interpretation of the fit and proper rules are not dissimilar to Australia where wide ranging principles have been laid down. Honesty and financial soundness are measures legislated in the Securities Markets Act 1988 (as amended in 2006). Competence and Capability are interpretive issues of a somewhat subjective nature, however the same UK and Australian regulatory practices that ensure the competence and capability of credit union and building society directors and managers are expected to apply in New Zealand.

3.15 Making Life Easier–Nipping Problems In The Bud Before They Develop

The day-to-day operations of any Credit Union or Building Society can bring problems. Happily most of these are readily resolved. However, some start off small but then fester away because nothing is done and they end up developing into major problems. Others loom large from the outset but even here, when we think back, there was often some indicator, some red light that we ignored or did not take enough notice of.

If these early warnings can be recognised, remedial action can be set in hand or at very least, there will be an awareness of a situation that needs to be watched.

To this end, the following list sets out some common situations that signal an underlying problem or one that could be in the making:-

- Poor operational performance arising from management deficiencies eg. weak financial, lending or marketing expertise.

- Lack of plausible business strategies to cope with the competitive marketplace.

- Lack of future investment strategies in terms of products, services, delivery channels and administrative efficiency.

* A general lack of understanding among the Directors of the implications of financial data and such areas as credit risk, liquidity management, market risk and operational risk.

* A Board that is not adequately responding to the rising expectations from the regulators about the standards of governance operating within the mutual ADI.

* Overly dominant Chair or CEO

* Poor communications and/or relations between Management and Board.

* Criticism that the Credit Union or Building Society is not giving enough back to members.

* Dissatisfaction by members concerning the slowness of decision making.

* Reluctance to undertake rigorous post-audits of mistakes.

* A rising level of delinquency in loan outstandings [and/or bad debt write-offs]

* Ongoing liquidity problems.

* Unanswered questions about high levels of expenditure.

* Inadequate financial reports.

* Symptoms of problems in financial area [eg. difficulties in reconciling monthly Bank Statements, irregular reconciliation of outstanding items suspense/clearing accounts]

* Continuing low capital adequacy [below 11%

* Irregular review of APRA Prudential Standards eg. Risk Management.

* Misgivings about internal security and the safety of Credit Union or Building Society assets.

* Dissatisfaction with Auditors and audit procedures [an ineffective Board Audit Committee]

* Frequent member complaint about the quality of service offered.

* A noticeable decline in demand for individual products.

* A valid criticism that deposit and loan rates are not competitive.

Obviously, there are other possibilities. The point is that if any of the above situations are present at your Credit Union or Building Society and nothing is being done to try and fix them, you and your colleagues should be on the alert.

The red light is showing! SO TAKE CARE!

While life wasn't meant to be easy, you don't have to make it any harder! Invariably, some relatively easy repair and maintenance now can save you considerable heartburn and worry down the track.