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UK & Ireland



Joining the right board: due diligence for prospective directors

May 2011



Guidance note

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1 Why undertake due diligence?

- 1.1 The review carried out by the late Sir Derek Higgs in 2003 on the role and effectiveness of non-executive directors recommended that before accepting an appointment, prospective non-executive directors should undertake their own thorough examination of the company to satisfy themselves that it is an organisation in which they can have confidence and in which they will be well suited to working. This advice clearly remains relevant today: by making the right enquiries, a prospective director can reduce the risk of unwelcome surprises and dramatically increase the likelihood of success.

2 How to undertake due diligence?

- 2.1 The prospective director should look at the company's annual report and website to see how the company articulates its position on the following matters: the company's business model, its governance, the market environment and dynamics, recent operational performance, strategy, risks and uncertainties, sustainability and financial performance. He/she should also look at the company's website to review regulatory and media announcements issued since the last annual report was published. There is a range of other sources of information listed in 4 below. Published material is unlikely to reveal wrongdoing; however a lack of transparency may be a reason to proceed with caution.

If you have any feedback on the content of these resources, or additional questions that you'd like to discuss, please contact the ICSA information centre: **020 7612 7035** | informationcentre@icsa.org.uk

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- 2.2 There follows in section 3 a list of questions of the type which the prospective director may want to consider. The list is not intended to be exhaustive, but is intended to be a helpful basis for the pre-appointment due diligence process that all directors should undertake. The answers to some of the questions can be found by reviewing the documents listed in 4 below. Where answers cannot be found, or should supplementary questions develop, the company should be approached for the answers, possibly at the one-to one meetings suggested in 2.3.
- 2.3 Before accepting a role, a prospective director should have pre-appointment meetings with the chairman, CEO, CFO, company secretary and all members of the nomination committee, if not the entire board. It may be beneficial to meet some directors in pairs, or in small groups (rather than solely relying on one-to one meetings) as this can give an indication of the dynamics between board members.

If the individual is joining with the intention of taking on the role of chairman of the company or chair of the audit or remuneration committee, meetings should also be set up with the auditors, the head of internal audit or the remuneration advisers as appropriate. All prospective directors should consider whether there are any other external advisers to the company, for example the corporate broker, with whom a meeting could provide relevant insights. Further information may be obtained from discussions with senior management, employees, suppliers and customers although care should be taken to preserve confidentiality as the fact that an approach to the individual, as a prospective director, has been made will usually be deemed to be price sensitive information.

- 2.4 The prospective director should check scheduled board dates for the year ahead at an early stage in the due diligence process to ensure he/she will be able to attend most, if not all, of the planned meetings in the first year.
- 2.5 The prospective director should be aware that the company will be unable to disclose certain confidential or price sensitive information prior to the formal appointment and should make him/herself aware of, and observe, the insider trading and market abuse laws and regulations in respect of inside information.

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3 Due diligence questions

3.1 The business

- What are the exact nature and extent of the company's business activities?
- What is the company's current financial position and what has its financial track record been over the last three years?
- What is the company's strategy?
- What are the company's culture and values as set by the board?
- Who are the company's stakeholders?
- What are the key dependencies (eg regulatory approvals, key licences)?
- What is the company's competitive position and market share in its main business areas?
- If the company operates in a regulated sector, what is the relationship with the regulator?
- What are the key issues being faced by the board at the moment?

3.2 Governance

- How well does the company articulate its position on governance in the annual report?
- What record does the company have on corporate governance issues?
- Does the company secretary have a reporting line into the chairman on board governance matters?
- Does the chairman report personally on governance, and about the role and effectiveness of the board?
- Is the company embracing or developing best practice?
- Does the governance report go further than the provisions of the UK Corporate Governance Code, for example giving a detailed explanation of the output from the board evaluation process?
- Is each board committee report headed by an introductory letter by the committee chairman setting out the key issues?
- Is succession at both management and board levels covered, and in what kind of detail?
- Are you satisfied that the internal regulation of the company is sound and that you can operate effectively within its stated corporate governance framework?

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3.3 The board

3.3.1 Board composition

- Who are the current executive and non-executive directors, what is their background and record and how long have they served on the board?
- Is the board composition suitably diverse to stimulate independent challenge and thought?
- Are there groups with a common agenda on the board, and what is their impact?
- Are you being brought on to the board to bolster an existing group, or to bring something new? If the latter, what is being expected of you and can you deliver it?
- Is there a range of skills on the board and are those skills and experiences aligned with the company's strategic direction, or does the strategy/ journey represent new territory for all the board members?
- Is the board composition keeping pace with the speed of change at the company? Does it meet the needs of the business?
- Is there the right balance of executives to non-executives to ensure that there is enough expert knowledge on the board of the company's operations?
- How is board composition and succession planning reviewed by the board?

3.3.2 Boardroom behaviours

- What are the dynamics of the relationships between chairman/ CEO, chairman/senior independent director, chairman/company secretary, executive/ non-executive directors and the company secretary/other directors etc?
- How is the leadership of the chairman perceived?
- Does the chairman set clear expectations concerning the company's culture, values and behaviours, and the style and tone of board discussions?
- Is constructive challenge from the non-executive directors welcomed?
- Does the chairman allow adequate time for debate?

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- Does the board have a high level of visibility and lead by example?
- What is the level of communication among board members between meetings?

3.3.3 Operational matters

- Has adequate thought been given to the board's decision-making processes?
- Do board papers provide high quality information, at a time far enough in advance of the meetings, to enable informed debate and high-quality decision making?
- Does the board agenda focus on the right things? Have you seen the schedule of matters reserved for the board's decision?
- Are board committee meetings structured so that there is sufficient time to allow a report to the board meeting and is adequate time allowed in board meetings to discuss committee matters?
- What is the attitude to site visits? How often does the board collectively or individually visit key locations?
- How is the strategy away-day handled? What matters have been covered on previous away-days?
- What is the practice in a typical board meeting week? Are there dinners before or after the meetings enabling the directors to get to know each other better, meet management below board level and discuss wider issues in a less formal and time-constrained environment?

3.3.4 Board evaluation

- Are there rigorous evaluations of the effectiveness of the board, its committees and the individual directors?
- Have external evaluations been undertaken?
- What are the key issues that came out of the last board evaluation?
- Does the chairman act on the results of board, committee and individual director evaluations?
- Are there areas for development on the board and what plans are there to tackle them?

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3.4 The role of the non-executive director

- Is the company clear and specific about the qualities, knowledge, skills and experience that it needs to complement the existing board? Will you be able to make a positive contribution?
- Can the chairman explain why you are suited to the role?
- What is the time commitment required and can you make this commitment? Could you find the time to deal with emergency situations outside of the routine board and committee meetings?
- If the company is not performing particularly well is there potential to turn it round and do you have the time, desire and capability to make a positive impact?
- Does the company offer a suitable director induction programme and adequate ongoing training/professional development? Is it clear from the company how you will acquire an understanding of the main areas of business activity, especially areas involving significant risk?
- Is there adequate internal support for the non-executives (typically from the company secretariat)?
- What are the internal protocols: does a new non-executive director channel everything through the chairman, CEO or company secretary, or is it accepted practice to contact the CFO, risk officer, head of internal audit etc directly if felt appropriate?
- Would accepting the non-executive directorship put you in a position of having a conflict of interest?
- Is it a good career move? Will you grow in terms of experience and/or ability as a result of joining the board?

3.5 Remuneration

- How well does the company articulate its position on remuneration in the annual report?
- What record does the company have on director remuneration issues?
- Are remuneration targets aligned with the long-term interests of shareholders?
- To what extent did shareholders support the remuneration report in the advisory vote at the last AGM?

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3.6 Investor relations

- Who owns the company, ie who are the company's main shareholders and how has the profile changed over recent years?
- What is the company's attitude towards, and relationship with, its shareholders?
- What questions were raised at the previous AGM?
- How often does the chairman meet shareholders; what kind of questions do they ask?
- When do the non-executive directors typically have the opportunity to meet with shareholders?

3.7 Risk management

- What are the main risks the company faces, and how are these risks managed?
- What is the risk appetite or tolerance of the company in the achievement of its strategic objectives?
- Are the risk assessments underpinned by proper analysis?
- Does the company have sound and effective systems of internal controls?
- What is the company's attitude towards, and relationship with, its stakeholders?
- Does the chairman ensure effective communication with the company's stakeholders?
- Is there anything about the nature and extent of the company's business activities that would cause you concern both in terms of risk and any personal ethical considerations?
- Is any material litigation presently being undertaken or threatened, either by the company or against it?
- What insurance cover is available to directors and what is the company's policy on indemnifying directors?

4 Further sources of information

- Company report and accounts, and/or any listing prospectus
- Company website
- Any corporate social responsibility or environmental report issued by the company
- Voting services reports
- Press reports
- Analysts' reports
- Rating agency reports



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Guidance notes are prepared by the ICSA policy team to support the work of company secretaries and other governance professionals working in the corporate and not-for-profit sectors, and in NHS trusts.

Guidance notes offer authoritative advice, interpretation and sample materials for the many issues involved in the management and support of boards. As such, they are invaluable for those helping their organisations to build trust through good governance.

There are over 100 guidance notes available to ICSA members at **www.icsa.org.uk/guidance**

The Institute of Chartered Secretaries and Administrators

Saffron House, 6–10 Kirby Street
London EC1N 8TS

May 2011



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