Board Delegations - Performance and Accountability

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Delegations of authority are an essential component of a board's ability to function effectively and add value to the organisation.

Most company constitutions state that the business of the company is to be managed by the directors or under their direction, with typically very few decisions reserved to members. This is also the position under the replaceable rules[1].

Yet for large organisations with predominantly non-executive directors, it is simply not possible for the board to manage the organisation's business. The board must engage others to assist, and in doing so must delegate part of its authority to manage the organisation's business.

This paper identifies the legislative underpinnings of board delegations and practical considerations boards should be mindful of when delegating authority and monitoring the exercise of authority by delegates. Deciding what authority to retain, what to delegate, and to whom is one of the most fundamental decisions a board must make and is a critical factor in determining the board's effectiveness.

When considering or reviewing their delegations of authority, many directors have an eye to self-protection. They are understandably focused on ensuring an appropriate framework of accountability and control is in place that protects their interests. It would be a mistake however to regard delegations of authority purely as an exercise in conformance. As well as protecting the interests of directors, a leading framework of delegated authorities will also promote the effective functioning of the board and management, with a clear focus on performance. Leading boards proactively delegate authority in a manner that promotes effective decision-making, accountability and efficiency, and maximises the opportunity for the board and management to perform at a very high level.

As well as their own delegations of authority, leading boards also understand how authority is sub-delegated throughout the ranks of management. This is a cornerstone of the organisation's internal governance and control environment and should be of real interest to boards and their audit and risk management committees. 'Management governance' (as opposed to 'board governance') has received very little attention in recent years and will be an area of far greater focus and scrutiny in years to come.

Delegated authorities should be regarded as the right to make or participate in decisions. They are sometimes referred to as 'decision rights'. Leading delegations frameworks

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[1] Australian Corporations Act, s198A, which is a replaceable rule

articulate the decision rights that apply for all material decisions made throughout the organisation, financial and non-financial.

Legislative provisions

The Australian Corporations Act expressly allows directors to delegate any of their powers to a board committee, director, employee or any other person, unless the company's constitution provides otherwise[2]. Many constitutions contain a similar provision authorising the directors to delegate authority.

Under the Act:

- A delegate must exercise the powers delegated to them in accordance with any directions of the board[3].
- Directors are responsible for the exercise of power by the delegate as if the power had been exercised by the directors themselves unless the director believed on reasonable grounds:
    - that the delegate would exercise the power in compliance with the directors' duties, the Act and the constitution, and
    - in good faith after making proper inquiry that the delegate was reliable and competent[4].

The Act also sets out the circumstances in which directors are entitled to rely on information or advice provided by others. A director can rely on information or advice provided by:

- an employee whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned,
- a professional adviser in relation to matters which the director believes on reasonable grounds to be within the adviser's professional competence,
- another director or officer in relation to matters within their authority,
- a committee of directors on which the director did not serve in relation to matters within the committee's authority[5].

These statutory provisions give rise to four fundamental realities for directors:

1. Directors must be very careful to whom they delegate authority, and should satisfy themselves as to the reliability and competence of each delegate.

[2] Corporations Act, s198D(1)

[3] Corporations Act, s198D(2)

[4] Corporations Act, s190

[5] Corporations Act, s189

2. Delegations by the board should be very clearly articulated to minimise ambiguity about who has the authority to make a particular decision.
3. The board should give very clear directions to their delegates about how their authority must be exercised.
4. Directors should also make appropriate inquiries and carefully consider the extent to which they ought to rely on the advice of others.

To Whom Boards Delegate Authority

Directors are prima facie responsible for the exercises of authority by their delegates as if the directors had exercised the authority. The directors are not responsible if they believed on reasonable grounds that the delegate was reliable and competent and would exercise the power in conformity with applicable requirements.

The most obvious and immediate implication is that directors must make appropriate inquiries and satisfy themselves as to the reliability and competence of a proposed delegate. They should also satisfy themselves that the delegate will exercise their authority in conformity with the directors' duties, the Act, the constitution and any other constraints imposed by the board on the exercise of authority.

In my experience, most boards tend to delegate authority only to other directors (including board committees) and officers. This practice is partly explained by the fact that directors are only excused from responsibility for the actions of a delegate where they reasonably believed the delegate would exercise authority in accordance with the directors' duties. It would be open to directors to reasonably form the view that the CEO and other directors will exercise authority in conformity with directors' duties. As an officer of the company, the CEO is subject to the same duties as directors, and is often also a director. It would be less reasonable for directors to form the same view in relation to other delegates who are not subject to the duties of directors and officers. Therefore, there is a strong legal driver for directors to delegate authority only to other directors and officers.

In addition, many boards also prefer a single point of accountability. In other words, they want one role that is accountable to them for managing the business of the organisation. This single point of accountability is the CEO.

It is much simpler and easier for a board to hold one role accountable than several. In the complex arena of board governance, simplicity is highly desirable where it can sensibly be achieved. Therefore where a board delegates authority to make a decision that relates to managing the organisation (as opposed to governing it), it usually makes that delegation to the CEO. Some boards also delegate authority to functional experts such as the CFO or General Counsel to endorse or review a proposed decision before the CEO or board makes the final decision. However the authority of the CEO's direct reports to approve decisions almost always flows to them via a sub-delegation of the CEO's authority.

Many boards also delegate authority to committees of the board such as the audit committee or remuneration committee. The trend among large, listed companies has been for these delegations to relate predominantly to the governance of the company (as opposed to management of it) and for the committee to be given authority to review a matter in detail and make recommendations to the board, rather than approve the matter outright. Authority to approve the matter is often (but not always) retained by the board as a whole.

For example, it is not uncommon for a nomination committee to develop and oversee the process by which a new director is recruited. The board as a whole will approve the recruitment process, appointment of the search firm, the shortlist of candidates and the final candidate to whom an offer is made.

Committees are often used by boards to delve into the detail of important matters where it is not an effective use of the board's time to go into the level of detail that is required. A smaller group of directors, often with deep expertise in the matter, can review the details more efficiently than the board as a whole.

Using committees in this way frees up precious time at board meetings and enables the board to focus on other matters and in particular its decision-making role.

Much of the work done by committees of large, listed companies relates to the board's role of monitoring performance and gaining assurance that management is exercising its authority within the constraints imposed by the board. Examples are the audit committee's role in monitoring risk management and internal controls and the remuneration committee's role in monitoring remuneration plans and the alignment of interests between management and shareholders.

Some boards delegate decision-making authority to their committees, however as noted above the trend among large listed companies has been to give committees authority only to 'review' or 'endorse' particular matters and make recommendations to the board. The board often retains authority to approve the matter, enabling all directors to participate in the final decision.

In addition to delegating authority to the CEO (usually in relation to managing the organisation) and board committees (in relation to governing it), many boards also make delegations to ad hoc committees or to individual directors.

Ad hoc committees are sometimes formed where important decisions are required in a tight timeframe and it is impractical for the board as a whole to meet as often as required, for example during a takeover. This enables the transaction to proceed with no disruption to the timetable and without the board abrogating its authority in relation to a matter of great importance. In these circumstances, the board might invite all directors to attend meetings of the ad hoc committee.

Some boards delegate authority to individual directors. A typical example is where the chairman is given authority to speak on behalf of the board outside of meetings, determine the agenda for board meetings, or approve other directors taking independent advice at the company's expense.

When delegating its authority, the board should always be mindful of the ability of individual directors to participate in decisions of great importance and to rely on decisions made by others.

How Boards Delegate Authority

Important decisions often require input from multiple stakeholders with different skills and knowledge to bring to bear, particularly the complex decisions that are often made by boards or top executives. It is important to clearly define how different stakeholders participate in key decisions and for what they are each accountable. Delegations of authority, starting with the board's delegations, should articulate that clarity to promote an organisational culture of accountability, efficiency and transparency.

Lack of clarity in decision-rights leads to poor accountability and inefficiency because it is unclear who can make a particular decision, and then who is responsible for it. In those circumstances, decisions are often made after various discussions have taken place, which is highly inefficient. Worse, nobody is certain who actually made the decision and who is accountable for it, whether it was good or bad. One of the more insidious downsides of this confusion is a general failure on the part of managers to take responsibility for their actions. This is a highly undesirable scenario that will never be associated with high performance.

Poor clarity also increases the risk of poor decision-making because there is little or no control over who should be involved in a particular decision. Conversely, leading organisations use their delegated authorities to clearly articulate who must participate in each material decision that is made, and what each participant is accountable for. They require the right people to be involved in important decisions in the right way, and clearly set out the differing accountabilities of executives with line management responsibility and those with functional responsibility.

For example, the board might require that an important announcement is reviewed and endorsed by the General Counsel and the CEO before being submitted to the board for approval. The General Counsel and the CEO will each be accountable for the advice they give the board and the board will be accountable for its decision to approve or reject the announcement.

The Corporations Act requires delegates of the board to exercise their authority in accordance with any directions given by the board[6]. The board should clearly articulate the boundaries within which the CEO and other employees must act when exercising their authority. This is usually achieved by the board approving mandatory policies, procedures and/or standards, with perhaps the most common example being an organisation's code of conduct. Some leading boards have used their charter to prescribe general limits on the CEO's conduct, and supplemented these with more detailed policies as necessary. This is

[6] Corporations Act, s198D(2)

consistent with Dr John Carver's model of policy governance[7]. A good example is BHP Billiton's board governance document[8].

Delegations by the board should be set out in formal instruments such as the board's charter, committee charters and a documented delegation to the CEO. These documents should be freely available to relevant internal stakeholders to ensure they are understood and followed such that important decisions are taken by the right people. Simply recording the board's delegations in minutes of meetings is not recommended.

Clear language should be used that is easy to understand and is based on the underlying decisions. Exceptions and carve outs should be ruled out or at the very least kept to a minimum. Leading organisations also include cross references to the relevant policies or procedures that apply in respect of each decision.

The board's delegations should be reviewed periodically to ensure they best meet the current needs of the organisation and the board must remain free to retract authority it has delegated whenever it wishes to do so. For example on the appointment of a new CEO it is not unusual for boards to narrow the range of decision-rights held by the CEO initially. As the board's confidence in the CEO grows, it might allow greater latitude in decision-making.

Benefits

There are several advantages of the board making clear delegations of authority:

1. Focus on What's Important - The board proactively controls its decision-making and streamlines its work through the judicious use of committees. Too many boards get bogged down in decisions that are brought to them for approval where either the board is in no position to add value to the decision, or it is a highly inefficient use of the board's time. Proactively prescribing what the board will decide and what it will delegate to others enables the board to set its own agenda and focus on matters of strategic importance where it can add the most value.
2. Efficiency - Clear delegations of authority enable people to understand which decisions require board approval and which do not. Uncertainty about this, as well as being highly dangerous, leads to inefficiency for both the board and management. "Last minute" requests for board approval are disruptive for directors and executives and a very poor use of time, especially the company secretary's.
3. Good Governance – Delegated authorities are the starting point for an organisation's governance framework. Who can decide what is of fundamental importance. Understanding how decision-rights are cascaded throughout the organisation also makes it much easier for the board to proactively decide what limits it wishes to place on the exercise of authority. The board can take a top down view of the policy boundaries it wishes to impose on decision-making. These policies can be linked to

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[7] www.carvergovernance.com

[8] www.bhpbilliton.com/home/aboutus/ourcompany/Documents/Board%20Governance%20Document.pdf

the delegated authorities in a clear governance framework with appropriate accountabilities and controls.

4. Risk Management – Through clear delegated authorities, the board can require that important decisions are made by the right people, after taking appropriate advice. Transparent delegations that are well understood also promote a culture of accountability where people take responsibility for their decisions, knowing they will be held accountable for them. All of this reduces the risk of poor decision-making.

Conclusion

Boards should periodically review the decision rights they retain and those they delegate. When delegating authority, directors should satisfy themselves as to the competence and reliability of the delegates and whether they are likely to exercise their authority appropriately. They should also think carefully about the limits they wish to impose on the exercise of delegated authority. Beyond these considerations of self-protection, boards should use their delegations of authority as a tool to foster good performance. First, they should proactively structure their activities to maximise their own performance. Secondly, they should establish a framework that promotes effective decision-making, productivity and accountability throughout the organisation.