

THE BUSINESS TIMES

BTINVEST

Published on Monday, 2 March 2015



Relying on Others – Where Does the Buck Stop?
By Victor Yeo

IN performing their corporate and fiduciary duties, directors are expected to exercise the same standard of care and diligence that a reasonable director, in the same position, would. The thing is, as businesses get more sophisticated and directors more educated, this standard has also risen in tandem. So much so that it has become increasingly unlikely that individual directors or even entire boards now have the necessary inherent expertise to ensure that the decisions they make are, indeed, the best ones for the company and that they do not inadvertently result in harm.

In other words, directors are now expected to pay attention to, and make decisions on, corporate matters which may actually be outside their personal or professional expertise. In a much discussed case in 2011 from Australia (commonly referred to as the "Centro" case), for example, the Australian court held that non-executive directors were liable for failing to note errors in their company's reported financial statements relating to the categorisation of certain short-term debts and guarantees. That decision means that, in Australia at least, directors are now expected to be familiar with the relevant Accounting Standards and to have a working knowledge of how these apply regardless of whether or not they have formal accounting training.

Seeking independent advice

The good news, however, is that the law does not expect directors to have infinite knowledge or expertise. In performing their duties, directors can, and should, rely on others for help. In the recent Singapore case involving the Airocean Group, the fact that the board sought independent legal advice on the contents of an announcement relating to the company's chief executive prior to its release was a key factor in absolving the independent directors from liability for recklessly breaching disclosure obligations.

In fact, section 157C of the Singapore's Companies Act specifically allows directors – when exercising their powers or performing their duties as a director – to rely on information and advice provided by competent third parties such as employees, professionals and independent experts.

Meanwhile, the Singapore Code of Corporate Governance recommends that directors be provided with not just complete, adequate and timely information prior to board meetings, but that they be provided on an on-going basis. The chairman is responsible for ensuring

Relying on Others – Where Does the Buck Stop?

this flow of information. To assist the chairman, companies should have in place procedures on the type of information the board should receive, as well as when and how such information should be disseminated. All directors should be familiar with these procedures and should actively make sure that they are complied with.

Acting responsibly and in good faith

Procedures should also be in place for directors to seek independent professional advice at the company's expense as and when required. That said, directors need to assure themselves as to the expertise and reliability of the persons on whose information they rely; they cannot take everything at face value. Indeed, the law requires directors act not only in good faith, but that they make proper inquiry where such inquiry is appropriate under the circumstances. Directors must also ensure that they have no knowledge of matters which may make such reliance unwarranted. They need to know what questions to ask and should not shy away from querying information and advice they receive. Specifically, they should have the skills and acumen to raise queries in a way that does not place others on the defensive unnecessarily; rather, the goal is to achieve clarity that will enhance the decision-making process.

Boards will then have to assess and process the information and advice they obtain when deciding on how best to proceed. Even at this stage, it is important to keep listening to the views of employees, independent advisers and fellow board members who may have deeper knowledge and understanding of the matter at hand.

Independent judgement remains paramount

Ultimately, however, directors have a legal duty to exercise their own independent judgment in good faith having regard to what is presented before them. This is a crucial consideration as it is common practice these days for boards to seek formal assurances from key employees and professional advisers about the information and opinions the boards receive.

In particular, employees who are asked to sign off on information or opinions they provided should not feel that they are being made to do so as scapegoats for potential errors. Instead, they should understand that they are an integral part of the governance process and that good governance is the responsibility of everyone in the company. Reliance on others is not about passing the buck; rather, it is an essential process for decision-making which, if used properly, will result in better decisions being made by the board.

The writer is a member of the Publications Committee of the Singapore Institute of Directors. This article first appeared in BTInvest, <http://www.btinvest.com.sg/specials/boardroom/relying-on-others-where-does-the-buck-stop/>