The role and duties of directors

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About Topic Gateways

Topic Gateways are intended as a refresher or introduction to topics of interest to CIMA members. They include a basic definition, a brief overview and a fuller explanation of practical application. Finally they signpost some further resources for detailed understanding and research.

Topic Gateways are available electronically to CIMA members only in the CPD Centre on the CIMA website, along with a number of electronic resources.

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The role and duties of directors

Definition

Director

‘A person appointed to carry out the day-to-day management of a company. A public company must have at least two directors, a private company at least one. The directors of a company, collectively known as the board of directors, usually act together, although power may be conferred (by the articles of association) on one or more directors to exercise executive powers; in particular there is often a managing director with considerable executive power.’

*Oxford Dictionary of Accounting, 1995*

Non-executive director (NED)

‘Director of a company (or other entity) who is not involved in the day-to-day running of operations and who is expected to provide an independent view on board issues.’

*CIMA Official Terminology, 2005*

Companies are directed and controlled by a system known as Corporate Governance. For further information see the separate Corporate Governance topic gateway. [www.cimaglobal.com/mycima](http://www.cimaglobal.com/mycima) [Accessed 13 May 2008]

The boards of directors are responsible for the governance of their companies. The board sets the company’s strategic aims and provides the leadership to put them into action. It supervises how the company is managed and reports to shareholders. The Board’s actions are subject to laws, regulations and shareholders in general meetings.

Context

In the current syllabus, students will learn and may be examined on company finance and management and on corporate governance in Paper CO5, Fundamentals of Ethics, Corporate Governance and Business Law.

Many people have director in their job title, but this topic gateway is about those directors who are appointed by shareholders to the board of their company.
Overview

Sought after qualities in directors

Strategic awareness and personal attributes are the most sought-after qualities for boardroom appointments. Company vision and strategy require business acumen and the ability to look ahead; to see the company as a whole and to understand the context in which it operates.

Desirable personal qualities include integrity, determination, creativity, originality, independence, balance, commitment, strategic and ethical awareness, accountability and responsibility. Some companies will value loyalty and team spirit more highly than originality and creativity.

The effective board

Effective board performance depends on how the different people and personalities interact. It is not just a case of having a group of outstanding individuals. New board members are often selected to complement the qualities of existing board members. The preferred candidate might be the person who best balances the team, not the most technically able individual.

A director does not have to be ‘good at everything’ but he or she does need to command respect from other board members. It is also advantageous to be a good team player. Directors should be able to demonstrate strategic awareness, decision making, communications and inter-personal skills.

For more information, see the IoD’s factsheet on the procedure for appointing directors. http://digbig.com/4wxfe
[Accessed 13 May 2008]

For more information, see the IoD’s factsheet on the procedure for removing directors. http://digbig.com/4wxff
[Accessed 13 May 2008]

The development of the law relating to company directors

The UK’s law relating to company directors is based on a combination of company law and a series of voluntary codes. These are summarised below.

Companies Act 1985. This sets out the responsibilities of companies, directors and company secretaries. The Act was a consolidation of various other pieces of company legislation, which applied only to companies incorporated under the Act. Sole traders, partnerships and limited liability partnerships were not covered by the Companies Act 2005. http://digbig.com/4wxfh
Companies Act 2006. This revised and superceded the Companies Act 1985. It will replace existing company legislation with the exception of provisions relating to company investigations and community interest companies. All parts of the Act will come into force by October 2008, although some provisions will apply earlier. [http://digbig.com/4wxfg](http://digbig.com/4wxfg) [Accessed 13 May 2008]

**Cadbury Committee (1992).** This committee looked at the composition of company boards and the appointment procedure for directors. It also considered the role and functions of the board, the qualities required of NEDs and executive directors’ pay. The committee’s findings resulted in the Cadbury Report of Best Practice on Corporate Governance.

**Greenbury Committee (1995).** This committee produced the Greenbury Report, which aimed to strengthen board accountability and encourage improved performance. It urged that executives’ pay should be determined by NEDs who had no vested interests.

**Hampel Committee (1996).** This committee reviewed the Cadbury Report of Best Practice on Corporate Governance and the recommendations of the Greenbury Report. In addition, the Hampel Committee kept the roles of executive and non-executive directors under review.

In 1998, the Hampel Committee produced its Combined Code, which included the work of the Cadbury and Greenbury Committees, as well as the Hampel Committee. The Code was passed to the London Stock Exchange to sit alongside the Listing Rules.

**Higgs Report (2003).** This report intended to examine the issue of corporate governance and build on the previous reports to produce a single, comprehensive Combined Code. The Higgs draft was passed on to the Financial Reporting Council. [www.frc.org.uk](http://www.frc.org.uk) [Accessed 13 May 2008]


The Combined Code implementation was reviewed in 2005. A small number of changes were incorporated in an updated version of the Code published in June...
Application

Companies Act 2006

The seven general duties of directors are set out in Part 10, Chapter 2, sections 171-177 of the Companies Act 2006. [Accessed 13 May 2008]

They are:

1. **Duty to act within powers**
   
   A company director must act in accordance with the company’s constitution and only exercise his or her powers for legitimate purposes.

2. **Duty to promote the success of the company**
   
   A company director must act in good faith to promote the success of the company for the members as a whole. He or she needs to consider:
   
   - the likely consequences of any decision in the long term
   - the interests of the company’s employees
   - the company’s business relationships with suppliers, customers and other stakeholders
   - the impact of the company’s operations on the environment
   - the desirability for the company to maintain a reputation for high standards of behaviour
   - the need to treat company members fairly.

3. **Duty to exercise independent judgement**

4. **Duty to exercise reasonable care, skills and diligence**

5. **Duty to avoid conflicts of interest**

   A company director must avoid situations where he or she has, or can have, a direct or indirect interest which conflicts, or could conflict, with the company’s interests.

6. **Duty not to accept benefits from third parties**
7. Duty to declare interest in proposed transaction or arrangement

Companies House regulations

Companies House regulations stipulate that every director of a limited company has a duty to deliver statutory documents to the Registrar as and when required by the Companies Act. These include:

- accounts for limited companies
- annual returns (Form 363)
- notice of change of directors or secretaries or in their particulars (Forms 288a/b/c)
- notice of change of registered office (Form 287).

They may delegate these duties to, for example, the company secretary but will remain responsible for the content and delivery.

Chapter 4 summarises what a limited company has to send to Companies House. [Accessed 13 May 2008]

Directors’ liabilities

Directors may incur personal liability, both civil and criminal, for their acts or omissions in directing a company. Under the Company Directors’ Disqualification Act 1986, a director can be disqualified from acting as a company director for between two and 15 years. The Insolvency Act 1986 stipulates that directors can be made personally liable for the company’s debts.

In cases of wrongful trading or fraudulent trading, the Court may require a director to make a personal contribution to the assets of the company.

For more information, see the IoD factsheet on the duties, responsibilities and liabilities of directors. [Accessed 13 May 2008]

Where directors have acted outside of the rules

British Airways case study

In August 2007, British Airways (BA) was fined £270m in a dual action by the UK and US competition authorities after admitting price fixing on fuel surcharges on its long-haul flights. It was revealed that members of the BA board colluded with Virgin Atlantic between August 2004 and January 2006 over the surcharges...
added to ticket prices in response to rising oil prices.

During that period, the extra charges increased from £5 to £60 a ticket on long-haul return flights, which was against the interests of BA passengers. This infringement of competition law was contrary to the directors’ duty to promote the success of the company as a whole. The price fixing treated BA passengers unfairly and it brought BA’s reputation for high standards of behaviour into disrepute.

Therefore it is essential that directors take their duties as set out in the Companies Act 2006 seriously, and that all regulations which apply to their role are adhered to in order to minimise the risk of conflict and the consequent irregularities. http://digbig.com/4wxfg
[Accessed 13 May 2008]

**A director’s service agreement**

An executive director has certain rights and responsibilities as an employee as well as a director of the company he or she serves. A director’s service agreement should include the following:

- appointment start date, notice required to terminate the contract, etc.
- duties of the director
- limitations of the director
- remuneration details (salary, bonus schemes, share options, medical insurance, life and disability insurance, pensions, company car, etc.)
- reimbursement of expenses
- holiday entitlement
- sickness entitlement
- provisions relating to disclosure of confidential company information
- provisions relating to intellectual property matters
- grievance, disciplinary and appeals processes
- evidence that the agreement has been passed by the board.

[Accessed 13 May 2008]
For further information, see the IoD factsheet on a director’s service agreement. http://digbig.com/4wxfp
[Accessed 13 May 2008]

This contains a list of recommended items that should be included in a model agreement.

**Loans, quasi loans and credit transactions**

There are specific regulations regarding loans, quasi loans and credit transactions to directors. For further information about these, refer to Part 10, Chapter 5, sections 197-214 of the Companies Act 2006. http://digbig.com/4wxfg
[Accessed 13 May 2008]

**Executive remuneration committee**

A company’s remuneration committee will determine the remuneration policy, contracts and compensation for executive directors. It will set the procedures for determining remuneration, including the function and procedure for the remuneration committee. The remuneration committee should comprise at least three members, all of whom must be non-executive directors.

For more information, see the IoD factsheet on how the remuneration committee should prepare. http://digbig.com/4wxfr
[Accessed 13 May 2008]

As there is an overlap between the issue of remuneration and corporate governance, please refer to the topic gateway on Corporate Governance for further information. Available from: www.cimaglobal.com/mycima
[Accessed 13 May 2008]

**Agency theory**

Agency theory is a hypothesis that attempts to explain elements of organisational behaviour through an understanding of the relationships between principals (such as shareholders) and agents (such as entity managers, directors and accountants). A conflict may exist between the actions undertaken by agents in furtherance of their own self-interest, and those required to promote the interests of the principals.

The result of the Agency theory is that in order to align the interests of principals and agents, remuneration packages often now include benefits that are linked to company performance, such as bonuses or share options.
Employee share options

Employee share options are another way of rewarding directors. This is a contract that gives the holder the right, but not the obligation, to subscribe to the entity’s shares at a fixed or determinable price for a specific period of time. This has potential implications for the integrity of the director.

For further information regarding shares, refer to Part 10, Chapter 5, section 219 of the Companies Act 2006. http://digbig.com/4wxfg
[Accessed 13 May 2008]

For further information regarding employee share options and PAYE (Pay As You Earn), refer to the advice from HMRC. http://digbig.com/4wxfs
[Accessed 13 May 2008]

For further information regarding Savings Related Share Option Schemes (SAYE), refer to the advice from HMRC. http://digbig.com/4wxfs
[Accessed 13 May 2008]

Taxation

Directors are subject to taxation as employed individuals. They are eligible to pay income tax and employee National Insurance Contributions (Class 1). They are also ultimately responsible for taxation matters within their company. The various company taxes include VAT (if registered), Corporation Tax and employer’s National Insurance Contributions (NICs). Directors and the limited company are two separate legal entities as regards taxation.

For more information on both individual and company taxation, see the HMRC website. http://digbig.com/4wxfs
[Accessed 13 May 2008]

Non-executive directors

Non-executive directors (NEDs) are appointed to bring to the board:

- independence
- impartiality
- wide experience
- special knowledge
- personal qualities.

The key responsibilities of NEDs include the following:
Strategic direction. A NED can have a clearer or broader view of external issues facing the company and its environs than the executive directors. A NED may be more objective in providing constructive criticism of company objectives and plans, and in executing them.

Monitoring. A NED should be responsible for monitoring the performance of executive management, especially the company objectives and strategy.

Communication. A NED can bring outside contacts to connect boards with potentially useful people.

The 1992 Cadbury Report stated that NEDs:

‘Should bring an independent judgement to bear on issues of strategy, performance and resources, including key appointments and standards of conduct.’

For more information, see the IoD factsheet on the role of non-executive directors. http://digbig.com/4wxft
[Accessed 13 May 2008]

For more information, see the IoD factsheet on selecting and appointing NEDs. http://digbig.com/4wxfw
[Accessed 13 May 2008]

For more information, see the IoD factsheet on a letter of appointment for a NED. http://digbig.com/4wxfx
[Accessed 13 May 2008]

The role of the managing director/chief executive

The managing director (or chief executive) is the most senior company executive (except where there is a company chairman). He or she is responsible for the company’s performance, as directed by the board’s overall strategy. He or she reports to the chairman or board of directors.

Key responsibilities include:

- formulating and implementing company policy
- directing a growth-led company strategy
- developing strategic plans according to the board’s long-term objectives and priorities
- maintaining an ongoing dialogue with the chairman.
For more information, see the IoD factsheet on the role of the managing director. http://digbig.com/4wxfy
[Accessed 13 May 2008]

For more information, see the IoD factsheet on the role of the chairman. http://digbig.com/4wxga
[Accessed 13 May 2008]

**The role of the board**

The exact role of the board varies according to the board and the size of the company. However, every board will have four key areas of responsibility. They are:

- establishing the company’s vision, mission and values
- determining company strategy
- delegating to management
- being accountable to shareholders.

For more information, see the IoD factsheet on the role of the board. http://digbig.com/4wxgb
[Accessed 13 May 2008]

For more information, see the IoD factsheet on the role of the board and its committees. http://digbig.com/4wxgc
[Accessed 13 May 2008]

**Combined Code on Corporate Governance**

The Combined Code on Corporate Governance (revised June 2006) gives board responsibilities and guidance to directors as to what they should do. http://digbig.com/4wxgm
[Accessed 14 May 2008]

This code, which is issued by the Financial Reporting Council, applies to reporting years beginning on or after 1 November 2006. It replaces the Combined Code issued in 2003 and has seven main principles relating to the conduct of board members. www.frc.org.uk
[Accessed 14 May 2008]

1. **The board**

   Every company should be headed by a board which is collectively responsible for its success. The board exists to secure prosperity by directing the
company’s affairs while meeting the needs of shareholders and other relevant stakeholders.

2. **Chairman and managing director/chief executive**

   There should be a clear division of responsibility between the two roles, with no one individual having unlimited decision making powers.

3. **Board balance and independence**

   The board should comprise a balance of executive directors and NEDs.

4. **Appointments to the board**

   All appointments to the board should be made in the correct way, including having a transparent procedure.

5. **Information and professional development**

   The board should be given timely and appropriate information so that it can discharge its duties effectively.

6. **Performance evaluation**

   The board should evaluate its own performance and that of individual directors.

7. **Re-election**

   All directors should re-stand for election at regular intervals.

For further information on the role of the board, refer to the topic gateway on Corporate Governance. Available from: [www.cimaglobal.com/mycima](http://www.cimaglobal.com/mycima) [Accessed 14 May 2008]

**References**


HMRC (HM Revenue and Customs)
Advice on taxation relating to directors. www.hmrc.gov.uk
Accessed 14 May 2008

Institute of Directors (IoD)
Various fact sheets relating to corporate governance and directors.
http://digbig.com/4wxgr
Accessed 14 May 2008

Further information

Articles
Full text available from Business Source Corporate through My CIMA
www.cimaglobal.com/mycima
[Accessed 13 May 2008]


Articles
Abstract only available from Business Source Corporate through My CIMA
www.cimaglobal.com/mycima
[Accessed 13 May 2008]


Books


**Other**

International Corporate Governance. February 2007, Issue 160

**CIMA Mastercourses**

Directors and their duties. To book via [www.cimamastercourses.com](http://www.cimamastercourses.com) please go to Find and key in the course code DRDU.

The role of the company secretary. To book via [www.cimamastercourses.com](http://www.cimamastercourses.com) please go to Find and key in the course code ROCO.

Develop into a director. To book via [www.cimamastercourses.com](http://www.cimamastercourses.com) please go to Find and key in the course code DEVD.

**Websites**

Companies House
UK company information exchange which is intended to help businesses, inform the public and benefit the economy. [www.companieshouse.gov.uk](http://www.companieshouse.gov.uk) [Accessed 13 May 2008]

Heidrick and Struggles
Heidrick and Struggles is a global executive recruitment firm which recruits at director level. [www.heidrick.com/default.aspx](http://www.heidrick.com/default.aspx) [Accessed 13 May 2008]

Institute of Directors (IoD)
The IoD supports, represents and sets standards for directors. [http://digbig.com/4wxgd](http://digbig.com/4wxgd) [Accessed 13 May 2008]
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