



Avoiding the pitfalls in running a private company

A practical guide for directors



Guidance on the principles of governance and how these may be applied
in the private company as it develops

**AVOIDING THE PITFALLS IN RUNNING A PRIVATE COMPANY:
A PRACTICAL GUIDE FOR DIRECTORS**

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private company as it develops**

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AVOIDING THE PITFALLS IN RUNNING A PRIVATE COMPANY: A PRACTICAL GUIDE FOR DIRECTORS

FOREWORD

**By Jim Mather CA MSP
Minister for Enterprise, Energy and Tourism
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In order to manage and grow a company successfully the members of the board need to know what is expected of them, both individually and collectively, and how to measure the achievement of these expectations. Using the well-established principles of corporate governance which have developed in the UK over the last fifteen years for listed companies, this booklet sets out a framework of governance suitable for private companies. It shows how this can be applied in a positive way, based upon the size of the company and the nature of any external investment.

This guide is designed to be practical and to assist directors when establishing or reviewing the company's governance procedures. It can also be used by someone who is asked to become a director, to help him or her in evaluating whether or not to join the company board.

I am pleased to support this publication by the Institute of Chartered Accountants of Scotland. It reinforces the reputation of ICAS as a provider of useful guidance to both its members and the wider business community.

Jim Mather

April 2008

Introduction

Good governance focuses on the relationships between board members, evaluating internal controls and it should support the leadership of the company by setting good standards of business behaviour. In doing so, it should improve the long term value of the company and assist in bringing discipline and accountability.

The Institute of Chartered Accountants of Scotland is pleased to publish this guide for the use of individual directors and for boards of private companies. Although corporate governance codes have been developed for publicly listed companies, we believe that the key principles and benefits are important to businesses of all sizes.

The Combined Code on Corporate Governance (the Code) sets out principles that need to be applied, and provisions with which listed companies are expected to comply, or to explain why they have not. However, for a smaller, private company, compliance with some or all aspects of the Code may not be practical or even appropriate. This guide considers those principles of the Code that we believe are the most relevant to private companies and discusses the manner in which they might be usefully applied. The main principles of the Code are included in Appendix E for information.

This guide is for:

- directors of a company who wish to apply a sound system of management and control as the company grows and develops
- individuals who are asked to join a business as a director to help them to assess the level of governance in the business
- shareholders of privately owned companies to benchmark the governance in the company against best practice
- external investors to assess what might be an appropriate level of governance for unlisted companies.

This guide is not intended to be prescriptive but simply to suggest ways in which private companies may develop good practice in governing their affairs. The board is responsible on a collective basis for ensuring that the company is well run on a day to day basis and is meeting its short and long term priorities. For the growing company the guide also provides a pathway to the framework set out in the Combined Code. The guide considers the collective responsibilities of the board, the role of each director, and risk management and internal controls. The practical implications of how each topic can be applied depending on the company's ownership are also considered.

The different stages of ownership of a company specifically identified in this guide are:

- 1 100% private ownership, either start-up or mature situation, i.e. the owner-managed company
- 2 100% private ownership, but with external commitments such as bank loans
- 3 Private ownership but with some shareholders who are not involved in the management
- 4 No longer in private ownership, for example, due to an AIM or full listing.

This guide focuses on the first three stages and Appendix B provides a brief series of questions designed to encourage debate about how a company is governed and whether oversight processes could be improved.

1 THE COLLECTIVE RESPONSIBILITIES OF THE BOARD

'Every company should be headed by an effective board, which is collectively responsible for the success of the company', according to the Combined Code. This is equally relevant for the private company. The board needs clarity of its role and responsibilities. The simplest way of doing this is to set these out in a board 'charter' which can be monitored and revisited on an ongoing basis. The responsibility of the board is to direct the affairs of the company to maximise its value for its shareholders and stakeholders as a whole. In doing so, the board must ensure the company complies with its articles as well as relevant legal, regulatory and governance requirements. The following paragraphs outline the collective responsibilities of a board and how they may apply in practice to the private company.

The Responsibilities of the Board

The board's key responsibilities are to:

- establish clear purpose, vision and values
- set appropriate strategy and structure
- delegate day-to-day authority to manage the business to management, monitor management's performance and hold them to account
- establish proper risk management and internal control frameworks
- provide leadership.

Practical considerations for the private company:

- In an owner-managed company the distinction between the board and the management may be blurred or non-existent. Nevertheless, time should be allowed for consideration of purpose, strategy and structure, risks and internal control.
- The growing company, with increasing staff numbers and external financing, should be encouraged to formalise the key responsibilities by discussing the board's role and setting it out in a clear statement.
- Any non-executive directors on the board should lead the monitoring of management performance, the challenge to the vision, values, strategy, risk management and internal controls, and should ensure that the board provides appropriate leadership.
- A company is unlikely to remain static and therefore its strategy and direction will evolve, meaning that the key responsibilities should be revisited on a regular basis.
- The board should have appropriate documentation to reflect and communicate the company's mission, business plan, and delegations. Appendix A shows a list of the range of documents that may be appropriate.

Matters Reserved for the Board

To make sure the board can exercise its oversight responsibilities, it retains approval authority for certain specific matters. These should be formally documented in a schedule of matters reserved and, in our view, would reserve to the board the approval of:

- changes to capital
- payment of dividends
- corporate objectives, strategies and structure
- corporate plans and all material changes to the corporate plans
- operating and capital budgets and all material changes to these budgets
- material transactions (e.g. acquisitions, disposals, starting or ceasing a business activity)
- the financial statements
- any borrowings or guarantees
- relevant external communications e.g. with any regulator or shareholders
- the appointment and remuneration of directors
- any authorities delegated to management

- political and charitable donations
- company policies
- compliance with legislation, for example in the areas of company law, employment, environmental matters, health and safety, wrongful trading and competition laws.

Practical considerations for the private company:

- Arguably, the smaller the company, the more important it is to identify someone else, such as the person providing company secretarial services, who can undertake the necessary oversight and operational decisions if need be, or in case of an emergency such as when the director(s) are not available. Alternatively, the owner manager may wish to appoint a power of attorney in case of such emergencies.
- In an owner-managed company those responsibilities undertaken by the owner manager and those delegated to staff should be clearly distinguished and understood.
- As the company grows there should be a regular review of which matters are reserved and which authorities are delegated.

Delegations of Authority

Operational matters need to be delegated in order to ensure the smooth running of the business and to allow the board to focus on its primary role. A schedule of delegations of authority should be established, which sets out the parameters of the delegated authority and particularly any financial limits. Areas that could be covered in the scheme of delegation include:

- opening bank accounts and authorising payments
- general purchasing powers/budgets
- signing of leases
- signing of regulatory documents
- powers of attorney
- external communication
- staff recruitment and remuneration
- health and safety operations
- compliance with current legislation, in particular, employment, health and safety and tax.

Practical considerations for the private company:

- In a smaller company the owner-manager usually retains responsibility for many of the above matters. It should be clear what areas are delegated, if any.
- As the company grows the owner/board needs to develop a systematic means of delegating authority and formalising this.
- Delegated authorities ought to be reviewed periodically to ensure that they are complied with and that the authorities remain appropriate for the size of the enterprise and its management structure.

Board Meetings

The board should meet often enough to complete its statutory and regulatory responsibilities and to exercise its oversight role properly. Good practice can be summarised as:

- an agenda should be prepared by the chairman and company secretary
- the agenda and any supporting papers should be circulated with sufficient time to allow directors to prepare for the meeting
- formal minutes of the meeting should be taken, ensuring all decisions are recorded and giving a flavour of the challenges and questioning raised by directors
- the minutes should include an action plan to ensure decisions are followed up in a reasonable timescale
- the meeting should monitor progress against the approved plans and budgets and ensure proper coverage of the matters reserved.

Practical considerations for the private company:

- In an owner-managed company it is good practice to set aside time for regular formal board meetings (and not just extend informal management meetings), at least to consider those aspects set out above.
- As a company grows, and particularly when external finance is introduced, the board may be expected to meet more frequently; for example on a monthly basis or around times when key reporting requirements are to be met (e.g. completion of annual report).
- It is also helpful to have documented procedures to deal with urgent issues which require board approval and arise between timetabled board meetings.
- Despite the Companies Act 2006 no longer requiring a private company to hold an AGM, companies with shareholders who are not involved in the management of the business may benefit from the discipline of a formal meeting to review the past year's activities and results, and the future prospects of the company.

Implementation and Compliance Schedules

The company should prepare, and keep updated, implementation schedules which show when the various financial, legal and regulatory requirements require to be completed and who is responsible for completing them. The schedules may include:

- preparation of accounts and their approval by the board
- filing accounts with Companies House and HMRC
- tax returns and payments
- preparation and submission of annual return to Companies House
- health and safety reviews and risk assessments
- employment matters.

Practical considerations for the private company:

- These principles are relevant regardless of the size or ownership of the company.
- Matters to be addressed in a compliance schedule are included at Appendix A.
- A specific individual should be responsible for monitoring the compliance schedule on a monthly basis. It is important to be aware that criminal penalties can arise from failure to comply with the submission deadlines. It is the directors who are responsible for company compliance and passing this work on to an adviser does not transfer this responsibility.

2 THE ROLE AND RESPONSIBILITIES OF INDIVIDUAL BOARD MEMBERS

An effective board should have a balance of skills and experience that is appropriate for the size and requirements of the business. In the smallest owner-managed companies it is probable that all responsibilities will fall on one or two people but as the company grows, so should the board. At the stage when a company wishes to list, the Combined Code expects a balance of executive and non-executive directors, and that the chairman should be separate from the chief executive. The following paragraphs outline the individual board members' responsibilities and how they may be undertaken in the private company as it grows and develops.

The Chairman

The chairman is appointed by the board and his duties include responsibility for:

- leadership of the board
- setting the board agenda and ensuring that directors have accurate and clear information
- the effectiveness of board meetings, including the induction, training and development of members of the board
- ensuring the company has an appropriate strategy, objectives, and risk controls
- communications with the shareholders.

Practical considerations for the private company:

- In a private company without external shareholders it is unusual to find the roles of chairman and chief executive as separate appointments. However, the individual fulfilling these two roles should remember that the responsibilities of each are separate and distinct.
- An independent chairman may be best practice but in a small company this is unusual and may not be commercially justifiable.
- Once a company has external financing and/or shareholders who are not involved in the management, it should have a chairman who is separate from the chief executive.

The Chief Executive

The chief executive is appointed by the board, and is responsible for managing the day to day business of the company and should have clear authority from the board to do so.

Practical considerations for the private company:

- A smaller company is usually run by its owner who assumes a range of roles. As the company grows it is best practice for the decision-making in the company to be spread between several (executive) directors or management.
- When a company seeks external financing, the role of the chief executive should be more clearly defined to be responsible for overall management of the business. With external financing there are new responsibilities on the management team and the board should consider whether it needs to recruit new directors.
- Once a company has shareholders who are not involved in the management, the chief executive should have a clearly defined role reporting to a board of directors.

The Secretary

Despite the fact that under the 2006 Companies Act a private company no longer needs to appoint a company secretary, the functions that the company secretary carries out remain. These consist of fulfilling the legal necessities and administration associated with running the company.

Practical considerations for the private company:

- In an owner-managed small company it may appear unnecessary to appoint a secretary; however, all the associated tasks should be included on a compliance schedule (see Appendix A) and allocated to a specific individual or individuals.
- A private company with only one director should consider appointing a company secretary so that there is more than one officer of the company in order to act if the director is incapacitated.
- With external shareholders, one person should have overall responsibility for shareholder information and dealing with shareholder communications.

Executive Directors and Non-Executive Directors

Executive directors have day-to-day management responsibilities, in addition to their responsibilities as members of the board. They are usually employed on a full-time basis by the company.

The role of non-executive directors is to participate fully in the functioning of the board, advising, supporting and challenging management as appropriate. They may be independent with no other links with the company (see Appendix C for the definition of an independent director). In particular, a non-executive director should:

- have suitable experience
- challenge and contribute to the development of strategy
- scrutinise the performance of management against the objectives of the company
- seek to ensure the integrity of financial information
- determine appropriate levels of remuneration and consider succession planning.

Practical considerations for the private company:

- In an owner-managed company a non-executive director may bring different experience and an external, more objective, viewpoint to the board.
- As a company grows, with wider responsibilities and external commitments, this should be reflected by giving consideration to introducing and/or increasing the number of non-executive directors.
- External investors will frequently insist on a non-executive director and the investor may assist in the appointment.

The Appointment of Non-Executive Directors

In selecting someone for appointment as a non-executive director, it is appropriate to consider the following:

- skills and experience
- professional qualifications
- references
- other appointments
- potential conflicts of interest
- sufficient time available to devote to the role
- likely remuneration package
- role and specific responsibilities on the board.

There should be a formal letter of appointment of the non-executive director which should detail the amount of time expected to be committed to the company and the basis of remuneration. (An executive director should have a service contract detailing his or her terms and conditions.)

Practical considerations for the private company:

- Points that may be addressed in a letter of appointment are noted in Appendix C.
- Period of appointment: Companies may appoint a non-executive director for a fixed period such as an initial three-year period, which can be renewed for further three year periods, as recommended in the Code. However, other companies may prefer the flexibility of an open ended agreement and this is common in private companies.
- The overall length of service should be carefully considered from the points of view of external perceptions and value to the company. In a highly specialised industry it may take a period of time for a non-executive director to become familiar with the business.

3 RISK AND INTERNAL CONTROL

The board's responsibilities identified earlier include the key elements of risk management and internal controls. Risk is an inherent part of being in business, and risk management is concerned with identifying, assessing, monitoring and mitigating risk, not necessarily removing it. An effective system of internal control is key to robust risk management. There should be a set of clearly documented procedures that tell those responsible what they must do or not do and, as part of an effective control system, there need to be regular checks to ensure that the procedures are operating effectively. The Combined Code states 'the board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets'.

The following paragraphs outline key aspects of risk management and internal control and how these may apply in the private company. The practical application will depend on a number of factors including the number of employees, the levels of delegation, the nature of the business and geographical spread, and the complexity of the company's practices and procedures.

Risk Management

A company should ensure that it has a continuous risk management process. This involves:

- agreeing the company's appetite for risk, for example, in some industry sectors the business model may be based on taking a higher degree of risk than competitors in order to achieve a premium price or other market advantage
- identifying the risks in the company's strategy; including strategic, operational, financial, regulatory, environmental or political risks
- taking appropriate measures to mitigate the risks identified
- establishing controls and review procedures to ensure that risk management is effective, and
- updating and improving these processes in the light of experience.

Practical considerations for the private company:

- In an owner-managed company risk management is generally addressed by the owner but is rarely documented, although making notes of even simple assessments can provide a focus to decision making and risk mitigation.
- A simple SWOT (strengths, weaknesses, opportunities and threats) analysis can be beneficial to identify key risks and opportunities.
- Understanding risk should be a company-wide responsibility but often in a smaller company it will be either the chief executive or finance director who will shoulder most of this responsibility. Where possible, involvement of other staff will almost always add to the effectiveness of the process.
- Professional advisers may be of assistance in identifying key risks and controls.
- In the growing company, reporting and monitoring procedures should be put in place so that the senior management team, board, and ultimately the shareholders, can be confident that risks are being properly identified and managed.
- In larger companies the creation of a risk management committee involving senior managers and directors should create the basis for more effective analysis of risks.
- A risk management policy needs to be regularly revisited to ensure that the company learns from its own experience, makes use of relevant industry knowledge, and takes account of changes in the external business environment.

Company Policies and Internal Controls

Company policies and procedures set out standards of behaviour and responsibilities for staff and the internal controls are the checks to ensure they are being properly applied. Policies are likely to be required across all aspects of the business to varying degrees depending on the scale and nature of the company's operations. These policies may cover the following:

- anti-fraud
- anti money-laundering
- business continuity
- internal and external communications
- human resources, remuneration, allowable expenses, and compliance with current legislation
- information security and reliability
- outside appointments
- purchasing/ procurement
- records management
- regulatory compliance
- health and safety compliance

An internal control system should consist of policies, procedures, allocation of responsibilities, and checks to ensure these are functioning. The system is unlikely to remain effective, however, unless it is reviewed regularly, and developed as the business grows to take account of new and emerging risks, control failures and market expectations or changes. Internal controls should include some or all of the following:

- Authorisation limits
- Segregation of duties
- Accounting reconciliations and monitoring of cash flow
- Suitable qualifications and training
- Budgetary controls
- Controls over incoming funds, expenditure and access to bank accounts
- Security of premises and control over assets

Practical considerations for the private company:

- Smaller owner-managed companies with few employees handle risks and controls quite informally but as a company grows a more formal system of internal control will become necessary.
- Basic control policies usually start with financial controls, insurance requirements, and health and safety.
- Strong financial controls and the ability to monitor any covenants will be essential if external financing is sought.
- Without regular review and monitoring of cash management, particularly in cash strapped companies, there may be exposure to wrongful trading or insolvency.
- As the company grows, the basic controls can be extended and, thereafter, the company should evaluate the level of risk attached to the above topics and the way in which these are controlled.

Business Continuity

A continuity plan should identify the key people and processes in an organisation which could place the company at risk if they were not available for whatever reason. The key areas are likely to include:

- key personnel - directors, managers, staff with specific skills, knowledge or licences
- premises
- IT systems
- supply chain
- customer, staff and supplier communication channels
- payroll, banking and financial systems.

The continuity plan should include an action plan for the company to continue to operate if something should happen in one of the identified key risk areas, including a timescale within which a back up resource must be made available. Reasons could include:

- unexpected death or serious illness of a key member or members of staff
- IT system crash or virus attack
- an unforeseen incident at any point in a company's supply chain
- loss of a single supplier, distributor, or customer
- payroll or financial system crash
- fire at company's premises.

The company should consider back-up procedures, which could include:

- regular back-up to a remote server for IT systems
- delegating key tasks to nominated alternative company personnel in the event of an emergency, with training to ensure alternative personnel are well briefed and competent
- ensuring that key company processes do not rely solely on one person within the organisation especially, for example, access to the company bank account or payroll system
- documenting emergency plans and alternative procedures if a company's supply chain or customer communications is affected, to minimise down-time, or if a company's premises are destroyed or otherwise unavailable.

Practical considerations for the private company:

- These principles are relevant to all private companies.
- In an owner-managed company, whilst it is good practice and advisable to consider business continuity this is not always undertaken due to time and cost restraints. Nevertheless a basic plan covering the key areas could possibly save the company if something unexpectedly goes wrong.
- Any business plan should be tested to establish as far as possible whether it works in practice, with any learning points identified in the test reflected in a revised plan. Testing might usefully involve third parties who have been identified as key elements of the continuity strategy.
- Many well run companies have a company manual, which consists of a documented record of the elements which have been discussed in this section, including key personnel and their responsibilities, the main company policy documents, and a risk register. Creating a comprehensive manual, and then reviewing it regularly, assists the board in governing the company in a structured manner. A company manual should also enable a person to cover someone else's responsibilities if necessary and therefore provide part of the contingency planning.
- In any private company, and in particular in an owner-managed company, it is important to consider a succession plan. This may need to be revisited periodically and plans are required to work towards its fulfilment. For example, will a younger member of the family take over, or do the owners have an ambition to sell to a rival, or float on AIM? If a company is seeking external investment or for the shareholders to sell out it is beneficial to have had, for example, a non-executive director, minuted board meetings, regular budgeting and so on to show that there is a proven record from which to negotiate.

Code of Business Conduct

Successful companies benefit from the highest standards of professional and ethical conduct from all directors and employees. A code of business conduct sets out these standards and supports and enhances a company's core values and culture. The existence of such a code also presents the company favourably externally. The principles of effective business conduct include:

- compliance with all applicable laws, regulations, and professional conduct standards
- high standards of service
- avoiding personal or financial conflicts of interest
- not being compromised through any unwarranted preferential treatment given to or accepted from customers, suppliers, or others
- communicating honestly and accurately with all stakeholders
- integrity and honest, ethical business practice
- contributing to the social and economic wellbeing of the community
- treating customers, suppliers and employees fairly and supporting employees' learning and development.

Practical considerations for the private company:

- Whilst this may initially appear to be an exercise for the larger company, all companies can benefit from formally considering and documenting the manner in which they wish to conduct their business and ensuring the company's values are applied in all the company's operations.
- With increasing numbers of staff it is useful to have the ethos of the company clearly expounded for induction, training and even disciplinary action purposes.

APPENDICES

Appendix A: Company Documents and Compliance Schedule

Company Documents

Written statements, in the form of company documents, help the board to clarify what it is doing and provide essential communications to staff and others. This allows all interested parties to know what is expected of them, the company's objectives, and how each party is expected to meet the objectives. Equally, funders and external stakeholders may wish to see the company objectives. The following company documents may be helpful:

Strategy and planning

A statement of the company's strategy may set out the overall aims and objectives, and can be supported by a business plan with the key objectives for the coming year. A medium term, two to five year plan may also be considered. These plans may consist simply of business objectives or they may also include financial plans.

Company manual

The company manual is a vital part of the internal controls and should document all policies and procedures including:

- Operating policies and procedures
- Staff policies and procedures
- Job descriptions
- Organisational chart
- IT policies, procedures and backup procedures
- Health and safety policies, and
- Legal and regulatory compliance schedule – see below.

Board statement

A board statement should consist of the board's responsibilities, reserved matters, and delegated authorities.

Compliance Schedule

The directors are responsible for ensuring that the company meets its legal and regulatory commitments so systems and timetables need to be in place. Reliance on advisers will not remove the directors' responsibility. The following matters need to be considered:

Accounts

- Preparation of annual accounts
- Board review and agreement of accounts
- Copy of accounts to members
- Filing of accounts with Companies House – within 10 months of year-end but the deadlines are being reduced to 9 months with the new Companies Act 2006, which will be effective for accounting periods commencing on or after 6 April 2008
- Filing of accounts and tax return with HMRC – within 12 months of year-end.

Annual Return

Check, amend if necessary, sign and return to Companies House within 28 days of receipt, along with fee.

Tax Compliance

- Corporation tax - for small and medium sized companies corporation tax needs to be paid within 9 months of the year-end and the return and accounts filed within 12 months. Large companies will need to make payments on account
- VAT – quarterly returns to be prepared and paid within one month
- PAYE – by 19th of each month, plus annual compliance following tax year-end
- P11Ds by 6 July following the relevant tax year

Companies House Compliance

Details of the following need to be returned to Companies House within set deadlines:

- Changes to the company's articles
- Certain resolutions
- Changes in directors and/or their details
- Change in company secretary and/or his details
- Change to the registered office
- Details of charges.

Banking facilities and covenants

Reporting requirements for company funding need to be met.

Health and safety compliance

A full health and safety policy should be in force at each location where the company operates with clear guidelines for staff and documentation of staff responsible for compliance.

Full risk assessments including fire risk assessment should be undertaken and reviewed at least annually.

Compliance with daily, monthly, and yearly safety checks eg first aid, fire alarms

Insurance

Annual review of insurance to ensure relevance to business and all areas covered, especially public and employer liability.

Appendix B: Questions: How is the Company Governed?

Provided below are a series of questions designed to encourage debate about how a company is governed and whether oversight processes could be improved. The questions should be considered in relation to the size and nature of the company, as discussed in the previous sections. Answers to these questions, together with a copy of the company's key policy statements, can be used to form the basis of a tailored company manual.

The Board Role

- 1 Is the board clear what the business is supposed to achieve for its owners?
- 2 Has it set goals to be achieved?
- 3 Has it determined the values and policies that will be adopted by the business?
- 4 Has it reviewed the strategic options available, selected those to be followed and decided how they will be implemented and resourced?
- 5 Does it ensure that policies and plans are implemented and reviewed regularly?

Responsibilities of Board Members

- 1 What is the job specification of each director?
- 2 Collectively, what skills do the board require to run the company effectively?
- 3 Are there any skills overlaps? Gaps?
- 4 Is any training required, how is this identified and organised?
- 5 How are new directors appointed, reappointed and, if necessary, removed?
- 6 Is there a succession plan?
- 7 Is there a person nominated to understudy key functions?

Matters reserved for the Board

- 1 Are corporate plans, operating and capital budgets prepared on a regular basis, for example, an annual cycle that ties in to the board calendar of meetings?
- 2 Who is responsible for instigating, preparing, reviewing and authorising of corporate plans and budgets?
- 3 Does the board undertake subsequent evaluations of plans to ensure they were adequately prepared, and follow up action for future plan preparation if necessary?
- 4 How does the board decide when dividends are to be recommended, how much they should be, and who organises their payment?
- 5 What is the board's definition of a material transaction, for example, acquisitions, disposals, starting or ceasing a business activity?

- 6 Who is responsible for instigating any material transaction?
- 7 How is a material transaction evaluated and does the board take a collective decision about its final authorisation?
- 8 Are there subsequent evaluations of material transactions?
- 9 Is there a business plan, a budget, and forecasted cash flow for the company and are these regularly monitored and, when necessary, updated?
- 10 Are actual results compared to budgets with variances investigated?
- 11 What are the procedures for preparing the annual financial statements?
- 12 Is the documentation and related information relating to all borrowings and guarantees up to date, reviewed regularly, and is each board member aware of the company commitments?
- 13 Are all covenants reviewed regularly to ensure that they are not breached?
- 14 Are borrowings as cost efficient as possible or should they be renegotiated?

Delegated Authorities

- 1 Are company policies current, clear and consistent, compliant with legal requirements and detailed in the company manual? Who is responsible for these policies?
- 2 Who can open bank accounts and sign cheques, and what are the limits on these authorities?
- 3 Which members of staff have authority for general purchasing, what are the relevant procedures, and what are the limits of their authority?
- 4 Who can sign regulatory documents and are there procedures in place to check these have been reviewed prior to submission?
- 5 Who is responsible for authorising the recipients and amounts of political and charitable donations?
- 6 Who has authority to represent the company or to issue external communications?
- 7 What are the procedures for recruiting staff?
- 8 Who has the ability to commit the company to signing of leases?

Board Meetings

- 1 Is the number of meetings appropriate and is there an annual calendar of board meetings?
- 2 How many directors are required for a valid (quorate) meeting?
- 3 Does the chairman set the agenda and can other directors add relevant business?
- 4 Is the management of meetings satisfactory with agenda papers sent out on a timely basis, sufficient time given to discuss all business, and minutes circulated promptly afterwards?
- 5 Are there suitable quality control checks in place to ensure that board papers contain appropriate, high quality, timely information to permit discussion and sensible decisions?
- 6 Do the minutes provide an adequate record of each meeting?
- 7 Are tasks allocated among directors, and how are these and any action points followed up?
- 8 What is the process for decision making, and is there a procedure for dealing with decision making between board meetings?

Compliance Schedule

- 1 Have external advisers and service providers, e.g. an accountant, pension adviser, auditor, been appropriately appointed with an engagement letter that details the required services, a commencement date, the basis of fees, and reporting requirements?
- 2 Is there a timetable and project plan in place for producing the annual report and (audited) accounts within the regulatory deadlines for their submission to Companies House and HMRC?
- 3 Do the timetables and project plans detail what is to be done so that any replacement person could undertake the tasks?
- 4 Do all the directors have sufficient opportunity to review the draft financial statements before they are signed?
- 5 Which government departments need to be dealt with, e.g. HMRC, Health and Safety, DWP, which director is responsible for these contacts, and what are the timetables for doing so?

Appendix C: Director's Appointment Letter, Induction, and the Definition of an Independent Director

Each director needs to be aware of his or her responsibilities, both the legal duties defined in various acts and those associated with his or her role in the company.

Director's Appointment Letter

The following aspects may be addressed in the director's letter of appointment:

- the date from which the appointment is effective
- whether there should be a fixed period of appointment and, if so, for how long (eg three years)
- state whether it is a contract for services (non-executive directors) or a contract of employment (executive directors)
- termination procedures, for example, at the discretion of either party with one/three months' notice
- the expected time commitment, of x number of days per annum, including attendance at all board meetings
- the legal responsibilities of a director
- the specific responsibilities expected in this appointment
- fees and expenses, and the basis of payment
- outside interests, and management of any potential conflicts of interest
- confidentiality during and after the period of the contract
- an anti-competitive clause both during and after the period of the contract
- induction procedures
- insurance: directors' liability insurance.

Director's Induction

New directors should be aware of the responsibilities associated with their appointment and be given as much background information about the company as possible. This allows them to make an effective contribution as early as possible. On the appointment of a new director the following should be addressed:

- announcement of appointment – e.g. press release, update the website, inform staff
- grant of share options – consider if any award is to be made and, if so, put in place
- register of outside appointments – ensure a record is kept and updated periodically
- notify Companies House of the appointment within 14 days
- there may be other regulatory requirements, for example, FSA requirements
- any background checks required, for example, Disclosure Scotland Form
- issue contractual terms of appointment
- complete a confidentiality agreement including a restriction on joining competitors
- check if there are any conflicts of interest or the possibility of related party transactions
- directors' liability insurance - prepare and issue an indemnification certificate
- access to financial statements, previous board minutes, company strategy and plans etc
- prepare any introductory meetings with staff, other directors, visits to the company (headquarters and operational sites).

After induction, there should be a formal programme of training and development for directors.

The Definition of an Independent Director

An Independent Director is someone outwith the company and, more specifically:

- has not been an employee of this company in the last five years
- has not had a material business relationship with the company in the last three years
- does not hold cross directorships or have significant links with other directors through involvement in other companies or bodies
- does not represent a significant shareholder
- has not received additional remuneration from the company apart from a director's fee, and does not participate in any company share option scheme, performance related pay scheme, or the company's pension scheme
- does not have close family ties with the company or the company's advisers, and
- has served on the board for less than nine years.

(Definition extracted from the Combined Code.)

Appendix D: Directors' Duties

The Companies Act 2006 has codified the duties of directors. These statutory duties are applicable to all directors regardless of the size of the company. There are seven general duties for directors:

- a director must act in accordance with the company's constitution and only exercise powers for the purpose for which they are conferred
- a director must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to the interests of employees, the community and the environment
- a director must exercise independent judgement
- a director must exercise the care, skill and diligence of a 'reasonably diligent person' having both the general knowledge, skill and experience reasonably expected of a director in his position (objective test), and the general knowledge, skill and experience which he actually has (subjective test)
- a director must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company
- a director must not accept any benefit connected with his role as a director from a third party unless it cannot reasonably be regarded as likely to give rise to a conflict of interest
- a director must declare the nature and extent of any personal interest in a proposed transaction with the company to the other directors before the company enters into the transaction.

The directors may wish to be able to demonstrate that they are acting 'in a way that promotes the success of the company' in which case this should be reflected in the board minutes.

There are other duties such as

- filing accounts and complying with Companies House requirements
- an awareness of the Insolvency Act 1986 in relation to fraudulent and wrongful trading and when to take advice on this. Board minutes are also crucial in establishing fraudulent or wrongful trading or otherwise, as the case may be.
- awareness of the Directors Disqualification Act 1986.

Appendix E: The Combined Code's Main Principles

The Combined Code is for public listed companies. Some, or aspects of, the main principles are relevant for private companies as discussed in the first part of this guide. The principles are reproduced here in order that any private company with ambitions to list in the future is aware of this governance code. The full code is available on the Financial Reporting Council website.

A1 – Every company should be headed by an effective board, which is collectively responsible for the success of the company.

A2 – There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.

A3 – The board should include a balance of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision-making.

A4 – There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.

A5 - The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.

A6 - The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

A7 – All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance. The board should ensure planned and progressive refreshing of the board.

B1 – Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for the purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.

B2 – There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

C1 – Financial Reporting: the board should present a balanced and understandable assessment of the company's position and prospects.

C2 – Internal Control: the board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.

C3 – Auditors: the board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors.

D1 – There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.

D2 – The board should use the AGM to communicate to investors and to encourage their participation.

Appendix F: Other Sources of Useful Information

Financial Reporting Council (FRC): www.frc.org.uk

The FRC is the UK's independent regulator responsible for promoting confidence in corporate reporting and governance. The FRC publishes the 'Combined Code on Corporate Governance'. It also has further guidance such as the Turnbull Report 'Internal Control: Guidance for Directors on the Combined Code', which has subsequently been revised and reissued by the FRC; and 'Good Practice Suggestions from the Higgs Report', which covers the role and effectiveness of non-executive directors.

Institute of Chartered Secretaries and Administrators (ICSA): www.icsa.org.uk

The ICSA provides guidance to company secretaries and senior administrators across all sectors.

The Institute of Directors (IOD): www.iod.com

The IOD supports, represents and sets standards for directors.

Quoted Companies Alliance: www.quotedcompaniesalliance.co.uk

The Quoted Companies Alliance (QCA) is a not-for-profit organisation that was formed solely to represent the interests of smaller quoted companies on the Main List, AIM and PLUS. It provides guidance on a range of topics including corporate governance.

Her Majesty's Revenue and Customs: www.hmrc.gov.uk

Guidance can be found regarding tax matters such as PAYE, corporation tax and value added tax.

Health and Safety Executive www.hse.gov.uk

The HSE provides information about, and ensures compliance with, health and safety matters

Business Gateway www.bgateway.com

The Business Gateway provides general business help and guidance for businesses in Scotland

Business Link www.businesslink.gov.uk

The Business Link provides general business help and guidance for businesses in England and Wales

The Advisory, Conciliation and Arbitration Service (ACAS) www.acas.org.uk

Acas aims to improve organisations and working life through better employment relations. It provides information, independent advice, high quality training and works with both employers and employees to solve problems and improve performance.

International Federation of Accountants (IFAC) www.ifac.org/paib

The International Center for Professional Accountants in Business, hosted by IFAC's Professional Accountants in Business (PAIB) Committee, provides resources and facilitates the exchange of knowledge and best practices among the more than one million professional accountants worldwide employed in commerce, industry, the public sector, education, and the not-for-profit sector.



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