

Due Diligence for Directors

A Guide to the Due Diligence Process that Prospective Directors should undertake before joining a Company.

Why undertake due diligence?

The review carried out by Derek Higgs and published in January 2003 as the review of the role and effectiveness of non-executive directors, recommended that before accepting an appointment, the prospective non-executive director should undertake their own thorough examination of the company to satisfy themselves that it is an organisation in which they can have faith and in which they will be well suited to working.

The Institute of Chartered Secretaries and Administrators assisted in the compilation of a list of questions for this purpose and undertook to keep them up to date. The questions as seen below are more or less as per the original Higgs report and as repeated in the Financial Reporting Council's re-issue of the Combined Code in July 2003. The order has, however, been re-arranged slightly and sub-headings added.

The following questions are not intended to be exhaustive, but are intended to be a helpful basis for the pre-appointment due diligence process that all non-executive directors should undertake. By making the right enquiries, asking the right questions and taking care to understand the replies, a prospective director can reduce the risk of nasty surprises and dramatically increase the likelihood of success.

Questions to ask

The business

- What is the company's current financial position and what has its financial track record been over the last three years?
- What are the exact nature and extent of the company's business activities?
- What is the company's competitive position and market share in its main business areas?
- What are the key dependencies (e.g. regulatory approvals, key licenses)?

Governance and investor relations

- What record does the company have on corporate governance issues?
- Does the company have sound and effective systems of internal controls?
- Who are the current executive and non-executive directors, what is their background and record and how long have they served on the board?
- What is the size and structure of the board and board committees and what are the relationships between the Chairman and the board, the Chief Executive and the management team?
- Who owns the company i.e. who are the company's main shareholders and how has the profile changed over recent years?
- What is the company's attitude towards, and relationship with, its shareholders?

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The role of the non-executive director

- Is the company clear and specific about the qualities, knowledge, skills and experience that it needs to complement the existing board?
- If the company is not performing particularly well is there potential to turn it round and do I have the time, desire and capability to make a positive impact?
- Am I satisfied that the size, structure and make-up of the board will enable me to make an effective contribution?
- Would accepting the non-executive directorship put me in a position of having a conflict of interest?
- Do I have the necessary knowledge, skills, experience and time to make a positive contribution to the board of this company?
- How closely do I match the job specification and how well will I fulfill the board's expectations?

Risk management

- Is there anything about the nature and extent of the company's business activities that would cause me concern both in terms of risk and any personal ethical considerations?
- Is any material litigation presently being undertaken or threatened, either by the company or against it?
- Am I satisfied that the internal regulation of the company is sound and that I can operate effectively within its stated corporate governance framework?
- What insurance cover is available to directors and what is the company's policy on indemnifying directors?

Sources of information

- Company report and accounts, and/or any listing prospectus, for the recent years.
- Analysts' reports.
- Press reports.
- Company website.
- Any Corporate Social Responsibility or Environmental Report issued by the company.
- Rating agency reports.
- Voting services reports.

Published material is unlikely to reveal wrongdoing, however a lack of transparency may be a reason to proceed with caution.

Further information may be obtained from discussions with existing directors, senior management, employees, suppliers and customers although care should be taken to preserve confidentiality especially considering that, in itself, the fact that an approach has been made will undoubtedly be deemed to be price sensitive information.

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