

ASX Corporate Governance Council

# Corporate Governance

**Principles**

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Good Corporate Governance

**and**

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**Recommendations**

2<sup>nd</sup> edition

Comparison with 1<sup>st</sup> edition

## Foreword

A decade ago, the term 'corporate governance' was barely heard. Today, like climate change and private equity, corporate governance is a staple of everyday business language and capital markets are better for it.

The ASX Corporate Governance Council was formed in August 2002 and has been chaired by the Australian Securities Exchange (ASX) since its inception. The Council is a remarkably diverse body, bringing together 21 business, investment and shareholder groups. Its ongoing mission is to ensure that the principles-based framework it developed for corporate governance continues to be a practical guide for listed companies, their investors and the wider Australian community. The Council's diverse range of voices is one of its strengths. Its striving for consensus is consistent with maintaining balance in regulatory and reporting affairs.

This document marks the first revision of the Council's corporate governance Principles and Recommendations since they were issued in March 2003. This is testimony to the durability of Australia's flexible, principles-based approach to corporate governance. While some other major jurisdictions are unwinding their governance frameworks because of unworkability, Australia has been able to refresh its approach rather than undertake a rewrite.

Support for Australia's approach is reflected in the continued high-level of reporting against the Council's Principles and Recommendations by the more than 2,000 entities listed on ASX. Overall reporting levels of corporate governance practice - the aggregate of adoption of recommended practices and of "if not, why not" reporting - have risen in each of the three years the Principles and Recommendations have been in operation prior to this revision. This is good news for investors. The more transparent listed entities are about their corporate governance practices, the better placed investors will be to make informed investment decisions.

Ultimately, it is for the market to pass judgement on the corporate governance practices of Australian companies, not the Council or ASX. The guidance provided by the Principles and Recommendations since 2003, with the cooperative goodwill of listed entities, has contributed to a high standard of corporate governance practice in Australia without the agency costs of 'black letter' law common in other markets.

Corporate governance is a dynamic force that keeps evolving. Council's challenge is to ensure that the Principles and Recommendations remain relevant to the Australian business and investment communities. The revised Principles and Recommendations are part of that process. They reflect the contributions of more than 100 public submissions and will take effect from 1 January 2008.

This document cannot be the final word. It is offered as guidance and will be reviewed again. Nor is it the only word. Good corporate governance practice is not restricted to adopting the Council's Recommendations. The arrangements of many entities differ from the Recommendations but amount equally to good practice. What matters is disclosing those arrangements and explaining the governance practices considered appropriate to an individual company's circumstance.

We are all – the Council, ASX and Australian market participants generally – in the business of preserving stakeholder confidence. That is the thread that runs through each of the Principles and Recommendations contained in this document. The wording may change, as necessary, from time to time, but that underlining theme will remain.

Eric Mayne  
Chair, ASX Corporate Governance Council  
August 2007

## Corporate governance in Australia

### What is corporate governance?

Corporate governance is, "the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations." It encompasses the mechanisms by which companies, and those in control, are held to account. <sup>1</sup> Corporate governance influences how the objectives of the company are set and achieved, how risk is monitored and assessed, and how performance is optimised.

Effective corporate governance structures encourage companies to create value (through entrepreneurialism, innovation, development and exploration) and provide accountability and control systems commensurate with the risks involved.

### The evolving nature of corporate governance

Corporate governance practices will evolve in the light of the changing circumstances of a company and must be tailored to meet those circumstances. Corporate governance practices must also evolve in the context of developments both in Australia and overseas.

There is no single model of good corporate governance. This document articulates eight core principles (the Principles). Each Principle is explained in detail, with commentary about implementation in the form of Recommendations (the Recommendations).

The ASX Corporate Governance Council's Recommendations are not mandatory and cannot, in themselves, prevent corporate failure or poor corporate decision-making. They are intended to provide a reference point for companies about their corporate governance structures and practices.

### The fundamentals

Fundamental to any corporate governance structure is establishing the roles of the board and senior executives - Principle 1, with a balance of skills, experience and independence on the board appropriate to the nature and extent of company operations - Principle 2. There is a basic need for integrity among those who can influence a company's strategy and financial performance, together with responsible and ethical decision-making which takes into account not only legal obligations but also the interests of stakeholders - Principle 3.

Meeting the information needs of a modern investment community is also paramount in terms of accountability and attracting capital. Presenting a company's financial and non-financial position requires processes that safeguard, both internally and externally, the integrity of company reporting - Principle 4, and provide a timely and balanced picture of all material matters - Principle 5. The rights of company owners, that is shareholders, need to be clearly recognised and upheld - Principle 6.

Every business decision has an element of uncertainty and carries a risk that can be managed through effective oversight and internal control - Principle 7. Rewards are also needed to attract the skills required to achieve the performance expected by shareholders - Principle 8. Each Principle is of equal importance.

<sup>1</sup> Justice Owen in the HIH Royal Commission, *The Failure of HIH Insurance Volume 1: A Corporate Collapse and Its Lessons*, Commonwealth of Australia, April 2003 at page xxxiii and Justice Owen, *Corporate Governance – Level upon Layer*, Speech to the 13<sup>th</sup> Commonwealth Law Conference 2003, Melbourne 13-17 April 2003 at page 2.

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Why is it important to Australia?

Corporate governance structures and practices continue to be important in determining the cost of capital in a global capital market. Australian companies must be equipped to compete globally and to maintain and promote investor confidence both in Australia and overseas. In an examination of our corporate governance practices, Australia starts from a position of strength. However, it is important to periodically review those practices to ensure they continue to reflect local and international developments and promote high standards of transparency about the corporate governance practices of listed entities.

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The ASX Corporate Governance Council

As a central reference point for companies to understand stakeholder expectations and to promote and maintain investor confidence, ASX convened the ASX Corporate Governance Council in August 2002. Its purpose was and remains to develop Recommendations which reflect international good practice. The ASX Corporate Governance Council includes representatives of:

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- Association of Superannuation Funds of Australia Ltd
- Australasian Investor Relations Association
- Australian Council of Superannuation Investors
- Australian Financial Markets Association
- Australian Institute of Company Directors
- Australian Institute of Superannuation Trustees
- Australian Shareholders' Association
- Australian Securities Exchange
- Business Council of Australia
- Chartered Secretaries Australia
- CPA Australia Ltd
- Financial Services Institute of Australasia
- Group of 100
- Institute of Actuaries of Australia
- The Institute of Chartered Accountants in Australia
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## Disclosure of corporate governance practices (following the “if not, why not?” approach)

### How to approach the Recommendations

The Recommendations are not prescriptions, they are guidelines, designed to produce an outcome that is effective and of high quality and integrity. This document does not require a “one size fits all” approach to corporate governance. Instead, it states suggestions for practices designed to optimise corporate performance and accountability in the interests of shareholders and the broader economy. If a company considers that a Recommendation is inappropriate to its particular circumstances, it has the flexibility not to adopt it - a flexibility tempered by the requirement to explain why the “if not, why not” approach.<sup>2</sup>

The ASX Corporate Governance Council encourages companies to use the guidance provided by this document as a focus for re-examining their corporate governance practices and to determine whether and to what extent the company may benefit from a change in approach, having regard to the company's particular circumstances.

There is little value in a checklist approach to corporate governance that does not focus on the particular needs, strengths and weaknesses of the company. The ASX Corporate Governance Council recognises that the range in size and diversity of companies is significant and that smaller companies from the outset may face particular issues in following all Recommendations. Performance and effectiveness can be compromised by material change that is not managed sensibly. Where a company is considering widespread structural changes in order to follow the Principles and Recommendations, the company is encouraged to prioritise its needs and to set and disclose practical goals against an indicative timeframe for meeting them.

### Disclosure requirements

Under ASX Listing Rule 4.10.3, companies are required to provide a statement in their annual report disclosing the extent to which they have followed the Recommendations in the reporting period. Where companies have not followed all the Recommendations, they must identify the Recommendations that have not been followed and give reasons for not following them. Annual reporting does not diminish the company's obligation to provide disclosure under ASX Listing Rule 3.1.

It is only where a Recommendation is not followed or where a disclosure requirement is specifically identified that a disclosure obligation is triggered. Each Recommendation is clearly identified as a disclosure obligation and the disclosure obligation is contained in the Guide to reporting at the end of each Principle. The Commentary that follows each Recommendation does not form part of the Recommendation and does not trigger a disclosure obligation. It is provided to assist companies to understand the reasoning for the Recommendation, highlight factors which may be relevant to consider, and make suggestions as to how implement the Recommendation.

The Guide to reporting which follows each Principle sets out what and where disclosure is required. In some cases the company is required to set out the relevant disclosure in a separate corporate governance statement in its annual report. Where the Corporations Act requires particular information to be included in the directors' report, the company has the discretion to include a cross-reference to the relevant information in the corporate governance section of the annual report rather than duplicating the information.

For more general information, there are requirements to make information publicly available, ideally on the company website. This information should be clearly presented in a separate corporate governance information section of the

<sup>2</sup> An exception regarding audit committees applies to companies comprising the S&P/ASX All Ordinaries Index. The ASX Listing Rules mandate the establishment of audit committees by those companies and require that the composition, operation and responsibility of the audit committee of companies in the top 300 of that Index comply with the Council's Recommendations. Top 300 companies is a reference made in Listing Rule 12.7 to the Top 300 companies listed in the S&P/ASX 300 at the beginning of the company's financial year. In an Exposure Draft released in June 2007, ASX has released a proposal to amend Listing Rule 12.7 to refer to companies in the “S&P/ASX 300 Index”. See the Exposure Draft of changes at [http://www.asx.com.au/about/regulatory\\_policy\\_unit/index.htm](http://www.asx.com.au/about/regulatory_policy_unit/index.htm). The proposed amendments are likely to come into effect at the end of 2007.

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- ¶¶ In some cases the company is required to set out the relevant disclosure in a separate corporate governance section of the annual report. Where the Corporations Act requires particular information to be included in the directors' report, the company has the discretion to include a cross-reference to the relevant information in the corporate governance section of the annual report rather than replicating that information.¶¶
- ¶¶ For more general information, there are requirements to make information publicly available, ideally by provision on the company's website. This information should be clearly presented in a dedicated corp( ... [9]
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website. The corporate governance statement in the annual report should contain references or links or instructions to navigate to the website to enable shareholders to gain access to this information readily.

### The "If not, why not" approach

Respondents to the ASX Corporate Governance Council's consultation on the changes to the Principles expressed strong support for the "if not, why not" approach but also expressed a desire for the ASX Corporate Governance Council to provide more explanation about this approach to reporting.

The ASX Corporate Governance Council considers that the Principles and Recommendations represent a distillation of practices that can assist companies to implement a robust corporate governance framework. However, the ASX Corporate Governance Council also acknowledges and endorses the finding of the first Implementation Review Group's Report that:

"...there is no typical organisation and no single readily identifiable model for corporate governance... At different times and stages in a company's life, some governance structures may be better for the generation of wealth for investors than others..."

It [is] important to distinguish between the purpose of the ...Principles and the purpose of the Recommendations. The Principles embody the broad concepts which underpin effective corporate governance. They encapsulate 'common sense' ideas with broad relevance. By contrast, the Recommendations given for each Principle suggest one framework for implementing the Principles within an organisation.

Disclosure of a company's corporate governance practice, rather than conformity with a particular model is central to the ASX Corporate Governance Council's approach."<sup>3</sup>

The ASX Corporate Governance Council supports companies seeking to meet the 'spirit' of the Principles through whatever means they believe are most appropriate to their business.

Nothing in the Principles and Recommendations precludes a company from following an alternative practice to that set out in a particular Recommendation, provided it explains its approach. This explanation of the alternative approach is the essence of "if not, why not" reporting. The ASX Corporate Governance Council considers that a well-reasoned "if not, why not" explanation from a company is a valid response to a particular Recommendation.

Effective "if not, why not" reporting practices involve:

- identifying the Recommendations the company has not followed
- explaining why the company has not followed the relevant Recommendation
- explaining how its practices accord with the 'spirit of the relevant Principle, that the company understands the relevant issues and has considered the impact of its alternative approach.

The ASX Corporate Governance Council considers the "if not, why not" reporting platform offers Australian companies a robust and flexible structure for governance disclosure and balances the genuine governance interests of public capital markets. The ASX Corporate Governance Council encourages companies to make use of the "if not, why not" approach, and other market participants to support this approach.

### What is the disclosure period?

The change in the reporting requirement applies to the company's first financial year commencing on or after 1 January 2008. Accordingly, where a company's financial year begins on 1 January, disclosure will be required in relation to the financial year 1 January 2008 – 31 December 2008 and will be made in the annual report published in 2009. Where a company's financial year begins on 1 July, disclosure will be required in relation to the financial year 1 July 2008 – 30 June 2009 and will be made in the annual report published in 2009.

The ASX Corporate Governance Council encourages companies to make an early transition to the revised Principles and Recommendations and companies are requested to consider reporting by reference to the Principles and

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<sup>3</sup> Implementation Review Group Report, released 31 March 2004 page 1ff.

Recommendations in their corporate reporting for the 2007 - 2008 year.

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### ASX Corporate Governance Council website

The ASX has dedicated a section of its website to assist companies with regard to these Principles and Recommendations. The site contains links to useful reference material and websites of ASX Corporate Governance Council members. It is located at [www.asx.com.au/corporategovernance](http://www.asx.com.au/corporategovernance).

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### Audit committees

There are specific requirements for companies within the S&P/ASX All Ordinaries Index in relation to audit committees.

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Listing Rule 12.7 requires a company in the S&P All Ordinaries Index at the beginning of its financial year to have an audit committee during that year. If the company was in the top 300 of that index at the beginning of its financial year, it must follow the Recommendations of the ASX Corporate Governance Council on the composition, operation and responsibility of the audit committee.<sup>4</sup> These are set out in Principle 4.

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### What entities are affected?

The Recommendations are directed at companies and other types of listed entities. Where appropriate, the term "company" is used in the Principles and Recommendations to encompass any listed entity, including listed managed investment schemes (trusts), listed stapled entities, and listed foreign entities. Also where appropriate, references to "shareholders" and "investors" will include references to unitholders of unit trusts. Specific application of the Principles and Recommendations for trusts and externally managed entities has been highlighted.

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The ASX Corporate Governance Council acknowledges that there are historical and legal reasons for the current governance practices of these listed collective investment entities. They are, however, an increasingly popular investment choice for retail investors. The ASX Corporate Governance Council considers it important that listed collective investment vehicles follow the spirit of the Principles, particularly in relation to the issues of independence and remuneration, and provide explanations in relation to their governance structures. This policy ensures that investors receive sufficient information to understand the governance processes of these vehicles and to form their own opinion as to their suitability.

### Companies not subject to the Corporations Act and the Accounting standards

As a result of the ASX Corporate Governance Council's review of the first edition of the Principles and Recommendations, three Recommendations have been removed from the revised Principles because their content is largely reflected in the Corporations Act and the Accounting Standards.<sup>6</sup> The ASX Corporate Governance Council

<sup>4</sup> See Note 2.

<sup>6</sup> The relevant sections of the Corporations Act are Section 295A, 250RA and 300A and AASB 124 *Related Party Disclosures*. Section 250RA [Auditor required to attend listed company' AGM] of the Corporations Act makes it an offence for the lead auditor not to attend a listed company's AGM, or arrange to be represented by a suitably qualified member of the audit team who is in a position to answer questions about the audit. Section 295A [Declaration in relation to listed entity's financial statements by chief executive officer and chief financial officer] into *Part 2M – Financial Reporting of the Corporations Act*. The directors' declaration under s295(4) can now only be made once the directors have received a declaration from the CEO and CFO, or equivalents that: (a) the financial records have been properly maintained, (b) the financial statements comply with accounting standards and (c) the financial statements and notes give a true and fair view. Section 300A [Annual Directors' Report – Specific information to be provided by listed companies – particularly Disclosure of remuneration policy and details] and AASB 124 *Related Party Disclosures*

considers that the vast majority of listed companies will benefit from removing duplications and overlap between the Principles and Recommendations and the Corporations Act and the Accounting Standards.

The ASX Corporate Governance Council has therefore amended Principles 6 and 8 to make it clear that where a listed company is not required to comply with sections 250RA and 300A of the Corporations Act or Australian Accounting Standard 124 *Related Party Disclosures* it should consider the range of means by which it might achieve the same ends. The company should include a statement in its annual report disclosing the extent to which it has achieved the aims of the relevant provisions during the reporting period and give reasons for not doing so.

Principle 7 also makes it clear that where a listed company is not subject to section 295A of the Corporations Act it should consider the range of means by which it can achieve the same ends and include in its annual report a statement disclosing the extent to which it has achieved the aims of section and provide reasons for not doing so.

The ASX Corporate Governance Council encourages these entities to follow the 'spirit' of the Principles and Recommendations and provide these disclosures.

### Improving corporate governance disclosures

As part of the review of the first edition of the Principles and Recommendations, the ASX Corporate Governance Council considered whether there were ways in which companies could improve their disclosures of corporate governance information. The ASX Corporate Governance Council commissioned a User Survey of professional and private investors conducted by the Council in late 2005 which was released in March 2006. The need for greater clarity when providing corporate governance information was one of the key findings of that Survey. Other suggestions in the User Survey for improving corporate governance information included:

- existing information could be clearer and more concise
- existing information could be more accessible
- more details about boards - board experience; independence and affiliations; commitments; share trading; committees including composition; policies and review processes
- clarity of information concerning remuneration of directors and senior executives
- a summary statement of whether companies are following the ASX Corporate Governance Council's Principles and Recommendations or providing "if not, why not" reporting.<sup>7</sup>

As part of its responsibilities for monitoring compliance with Listing Rule 4.10.3 ASX has undertaken three annual reviews of companies' corporate governance disclosures. The ASX review of corporate governance disclosures in 2006 annual reports made the following suggestions for ways in which companies could improve their corporate governance disclosures:

- companies should be encouraged to improve their compliance with Listing Rule 4.10.3 by simplifying their corporate governance statements. This could be achieved by dealing with the Recommendations consecutively on a Recommendation - by - Recommendation basis. Some of the better reports provided information in this format either in narrative or tabular form
- clear cross-references to the location of information not included in the corporate governance statement but located elsewhere in the annual report or websites were also useful.<sup>8</sup>

The ASX Corporate Governance Council encourages companies to consider these suggestions when reporting.

### **Monitoring implementation and change**

The ASX Corporate Governance Council is committed to a continuing review of these Principles and Recommendations to ensure that they remain relevant, take account of local and international developments, and continue to reflect international best practice.

Companies and investors are encouraged to provide feedback about the implementation and impact of these

**Deleted:** This document represents the first iteration of the ASX Corporate Governance Council's views about best practice. Corporate governance practices must be evolutionary and responsive to the information needs of local and international investors.

<sup>7</sup> See the Survey at [www.asx.com.au/supervision/pdf/asx\\_corporate\\_governance\\_summary\\_march06](http://www.asx.com.au/supervision/pdf/asx_corporate_governance_summary_march06).

<sup>8</sup> See *Analysis of Corporate Governance Practice Disclosure in 2006 Annual Reports* at [http://www.asx.com.au/supervision/governance/monitoring\\_compliance.htm](http://www.asx.com.au/supervision/governance/monitoring_compliance.htm).

Recommendations to the ASX Corporate Governance Council ~~directly or to one of its member bodies.~~

~~As with the first edition of the Principles,~~ the ASX Corporate Governance Council will formally ~~continue to~~ review the impact of these Principles and Recommendations following collation and examination of disclosures made in annual reports and consideration of feedback received.

### Acknowledgements

The ASX Corporate Governance Council's Principles and Recommendations have benefited from the invaluable contributions made by a number of industry associations, corporate governance experts and listed companies ~~and their~~ directors. ~~The ASX Corporate Governance~~ Council is most grateful for their input, and for invaluable editorial contributions and assistance.

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## **The Corporate Governance Principles and Recommendations**

### **Principle 1 – Lay solid foundations for management and oversight**

Companies should establish and disclose the respective roles and responsibilities of board and management.

Recommendation 1.1: Companies should establish the functions reserved to the board and those delegated to senior executives and disclose those functions.

#### **Box 1.1 Content of a director's letter upon appointment**

Recommendation 1.2: Companies should disclose the process for evaluating the performance of senior executives.

Recommendation 1.3: Companies should provide the information indicated in the Guide to reporting on Principle 1.

### **Principle 2 - Structure the board to add value**

Companies should have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.

Recommendation 2.1: A majority of the board should be independent directors.

#### **Box 2.1: Relationships affecting independent status**

Recommendation 2.2: The chair should be an independent director.

Recommendation 2.3: The roles of chair and chief executive officer should not be exercised by the same individual.

Recommendation 2.4: The board should establish a nomination committee.

Recommendation 2.5: Companies should disclose the process for evaluating the performance of the board, its committees and individual directors.

Recommendation 2.6: Companies should provide the information indicated in the Guide to reporting on Principle 2.

### **Principle 3 - Promote ethical and responsible decision-making**

Companies should actively promote ethical and responsible decision-making.

Recommendation 3.1: Companies should establish a code of conduct and disclose the code or a summary of the code as to:

- the practices necessary to maintain confidence in the company's integrity
- the practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders
- the responsibility and accountability of individuals for reporting and investigating reports of unethical practices.

#### **Box 3.1: Suggestions for the content of a code of conduct**

Recommendation 3.2: Companies should establish a policy concerning trading in company securities by directors, senior executives and employees, and disclose the policy or a summary of that policy.

#### **Box 3.2: Suggestions for the content of a trading policy**

Recommendation 3.3: Companies should provide the information indicated in the Guide to reporting on Principle 3.

#### Principle 4 - Safeguard integrity in financial reporting

Companies should have a structure to independently verify and safeguard the integrity of their financial reporting.

Recommendation 4.1: The board should establish an audit committee.

Recommendation 4.2: The audit committee should be structured so that it:

- consists only of non-executive directors
- consists of a majority of independent directors
- is chaired by an independent chair, who is not chair of the board
- has at least three members.

Recommendation 4.3: The audit committee should have a formal charter.

Recommendation 4.4: Companies should provide the information indicated in the Guide to reporting on Principle 4.

#### Principle 5 - Make timely and balanced disclosure

Companies should promote timely and balanced disclosure of all material matters concerning the company.

Recommendation 5.1: Companies should establish written policies designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior executive level for that compliance and disclose those policies or a summary of those policies.

##### Box 5.1: Continuous disclosure policies

Recommendation 5.2: Companies should provide the information indicated in the Guide to reporting on Principle 5.

#### Principle 6 - Respect the rights of shareholders

Companies should respect the rights of shareholders and facilitate the effective exercise of those rights.

Recommendation 6.1: Companies should design a communications policy for promoting effective communication with shareholders and encouraging their participation at general meetings and disclose their policy or a summary of that policy.

##### Box 6.1: Using electronic communications effectively

Recommendation 6.2: Companies should provide the information indicated in the Guide to reporting on Principle 6.

#### Principle 7- Recognise and manage risk

Companies should establish a sound system of risk oversight and management and internal control.

Recommendation 7.1: Companies should establish policies for the oversight and management of material business risks and disclose a summary of those policies.

Recommendation 7.2: The board should require management to design and implement the risk management and internal control system to manage the company's material business risks and report to it on whether those risks are being managed effectively. The board should disclose that management has reported to it as to the effectiveness of the company's management of its material business risks.

Recommendation 7.3: The board should disclose whether it has received assurance from the chief executive officer (or equivalent) and the chief financial officer (or equivalent) that the declaration provided in accordance with section 295A of

the Corporations Act is founded on a sound system of risk management and internal control and that the system is operating effectively in all material respects in relation to financial reporting risks.

Recommendation 7.4: Companies should provide the information indicated in the Guide to reporting on Principle 7.

Principle 8- Remunerate fairly and responsibly

Companies should ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to performance is clear.

Recommendation 8.1: The board should establish a remuneration committee.

Recommendation 8.2: Companies should clearly distinguish the structure of non-executive directors' remuneration from that of executive directors and senior executives.

Box 8.1: Guidelines for executive remuneration packages

Box 8.2: Guidelines for non-executive director remuneration

Recommendation 8.3: Companies should provide the information indicated in the Guide to reporting on Principle 8.

Principle 1:  
Lay solid foundations for management and oversight

~~Companies should establish and disclose~~ the respective roles and responsibilities of board and management.

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The company's framework should be designed to:

- enable the board to provide strategic guidance for the company and effective oversight of management
- clarify the respective roles and responsibilities of board members and senior executives in order to facilitate board and ~~senior executives'~~ accountability to both the company and its shareholders<sup>9</sup>
- ensure a balance of authority so that no single individual has unfettered powers.

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~~Recommendation 1.1: Companies should establish~~ the functions reserved to the board and those delegated to ~~senior executives, and disclose those functions~~

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Commentary and guidance

*Role of the board and management*

~~Boards should~~ adopt a formal statement of matters reserved to ~~them~~ or a formal board charter that details their functions and responsibilities. ~~There should be~~ a formal statement of ~~the areas of authority delegated to senior executives~~.

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The nature of matters reserved to the board and delegated to ~~senior executives~~ will depend on the size, complexity and ownership structure of the company, and will be influenced by its tradition and corporate culture, and by the skills of directors and ~~senior executives~~.

Disclosing the division of responsibility assists those affected by corporate decisions to better understand the respective accountabilities and contributions of ~~the~~ board and ~~senior executives~~. That understanding can be further enhanced if the disclosure includes an explanation of the balance of responsibility between the chair, ~~the~~ lead independent director, if any, ~~and~~ the chief executive officer, ~~or~~ equivalent.

The division of responsibility may vary with the evolution of the company. Regular review of the balance of responsibilities may be appropriate to ensure that the division of functions remains appropriate to the needs of the company.

*Responsibilities of the board*

Usually the board ~~will~~ be responsible for:

- ~~overseeing~~ the company, including its control and accountability systems
- appointing and removing the chief executive officer, ~~or~~ equivalent
- ~~where appropriate~~, ratifying the appointment and the removal of ~~senior executives~~,
- ~~providing~~ input into and final approval of management's development of corporate strategy and performance objectives
- reviewing, ~~ratifying and monitoring~~ systems of risk management and internal control, codes of conduct, and legal compliance
- monitoring senior ~~executives'~~ performance and implementation of strategy,
- ~~ensuring appropriate resources are available to senior executives~~,
- approving and monitoring the progress of major capital expenditure, capital management, and acquisitions and divestitures
- approving and monitoring financial and other reporting.

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*Allocation of individual responsibilities*

It is also appropriate that directors clearly understand corporate expectations of them.

<sup>9</sup> Senior executives refers to the senior management team as distinct from the board, being those who have the opportunity to materially influence the integrity, strategy and operation of the company and its financial performance.

To that end, formal letters upon appointment for directors setting out the key terms and conditions relative to that appointment are useful.

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Suggestions for the contents of the letter are contained in Box 1.1.

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**Box 1.1 Content of a director's letter upon appointment**

Companies may find it useful to consider the following matters when drafting directors' letters upon appointment:

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- term of appointment
- time commitment envisaged
- powers and duties of directors
- any special duties or arrangements attaching to the position
- circumstances in which an office of director becomes vacant
- expectations regarding involvement with committee work
- remuneration, including superannuation and expenses
- requirement to disclose directors' interests and any matters which affect the director's independence
- fellow directors
- trading policy governing dealings in securities (including any share qualifications) and related financial instruments by directors, including notification requirements
- induction training and continuing education arrangements
- board policy on access to independent professional advice
- indemnity and insurance arrangements
- confidentiality and rights of access to corporate information
- a copy of the constitution
- organisational chart of management structure.

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Similarly, senior executives including the chief executive officer, or equivalent, and the chief financial officer, or equivalent, should have a formal job description and letter of appointment describing their term of office, duties, rights and responsibilities, and entitlements on termination. Box 8.1 (Principle 8) provides further commentary on the matter of termination entitlements.

Recommendation 1.2: Companies should disclose the process for evaluating the performance of senior executives.

Commentary and Guidance

The performance of senior executives should be reviewed regularly against appropriate measures.

Induction and education

Induction procedures should be in place to allow new senior executives to participate fully and actively in management decision-making at the earliest opportunity.

To be effective, new senior executives need to have a good deal of knowledge about the company and the industry within which it operates. An induction program should be available to enable senior executives to gain an understanding of:

- the company's financial position, strategies, operations and risk management policies
- the respective rights, duties and responsibilities and roles of the board and senior executives.

Recommendation 1.3: Companies should provide the information indicated in the Guide to reporting on Principle 1.

**Guide to reporting on Principle 1**

The following material should be included in the corporate governance statement in the annual report:

- an explanation of any departure from Recommendation 1.1, 1.2 or 1.3

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- whether a performance evaluation for senior executives has taken place in the reporting period and whether it was in accordance with the process disclosed.

A statement of matters reserved for the board, or the board charter or the statement of areas of delegated authority to senior executives, should be made publicly available, ideally by posting it to the company's website in a clearly marked corporate governance section.

#### Application of Principle 1 in relation to trusts and externally managed entities

References to "board" and "directors" should be applied as references to the board and directors of the responsible entity of the trust and to equivalent roles in respect of other externally managed entities.

A trust should clarify the relationship between the responsible entity and the parent company where relevant, and articulate the relevant roles and responsibilities of the board and management of the responsible entity.

Trusts should also have regard to the responsibilities of external directors and the compliance committee under Part 5C.5 of the Corporations Act.

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*A Guide to Directors and Officers Liability Insurance*, 1st edition, June 2001, authors C. Smith, N. Milne, F. Morris. Published by Australian Institute of Company Directors.¶

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Principle 2:  
Structure the board to add value

Companies should have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.

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An effective board is one that facilitates the effective discharge of the duties imposed by law on the directors and adds value in a way that is appropriate to the particular company's circumstances. The board should be structured in such a way that it:

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- has a proper understanding of, and competence to deal with, the current and emerging issues of the business
- exercises independent judgement
- encourages enhanced performance of the company
- can effectively review and challenge the performance of management.

Ultimately the directors are elected by the shareholders. However the board and its delegates play an important role in the selection of candidates for shareholder vote.

Recommendation 2.1: A majority of the board should be independent directors<sup>10</sup>.

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Commentary and guidance

Independent decision-making

All directors – whether independent or not - should bring an independent judgement to bear on board decisions.

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To facilitate this, there should be a procedure agreed by the board for directors to have access in appropriate circumstances to independent professional advice at the company's expense.

Non-executive directors should consider the benefits of conferring regularly without management present, including at scheduled sessions.<sup>11</sup> Their discussions can be facilitated by the chair or lead independent director, if any.

Independent directors

An independent director is a non-executive director who is not a member of management, and who is free of any business or other relationship that could materially interfere with - or could reasonably be perceived to materially interfere with - the independent exercise of their judgement.

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Relationships which may affect independent status are set out in Box 2.1.

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Directors considered by the board to be independent should be identified as such in the corporate governance statement in the annual report. The board should state its reasons if it considers a director to be independent notwithstanding the existence of relationships listed in Box 2.1 and the corporate governance statement should disclose the existence of any such relationships. In this context, it is important for the board to consider materiality thresholds, from the perspective of both the company and its directors, and to disclose these.<sup>13</sup>

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The board should regularly assess the independence of each director in light of interests disclosed by them. So that it can do this, each independent director should provide to the board all relevant information.¶  
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<sup>10</sup> A series of relationships affecting independent status are set out in Box 2.1.

<sup>11</sup> At times it may be appropriate for the independent directors to meet without other directors present.

<sup>13</sup> For example, a board may decide that affiliation with a business which accounts for, say, less than X% of the company's revenue is, as a category, immaterial for the purpose of determining independence. If the company discloses the standard it follows, and makes a general statement that the relevant director meets that standard, investors are better informed about the board's reasoning.

**Box 2.1: Relationships affecting independent status**<sup>14</sup>

When determining the independent status of a director the board should consider whether the director is:

1. is a substantial shareholder of the company or an officer of, or otherwise associated directly with, a substantial shareholder of the company<sup>16</sup>
2. is employed, or has previously been employed in an executive capacity by the company or another group member, and there has not been a period of at least three years between ceasing such employment and serving on the board
3. has within the last three years been a principal of a material professional adviser or a material consultant to the company or another group member, or an employee materially associated with the service provided
4. is a material supplier or customer of the company or other group member, or an officer of or otherwise associated directly or indirectly with a material supplier or customer
5. has a material contractual relationship with the company or another group member other than as a director of the company

Family ties and cross-directorships may be relevant in considering interests and relationships which may compromise independence, and should be disclosed by directors to the board.

**Regular assessments**

The board should regularly assess whether each non-executive director is independent. Each non-executive director should provide to the board all information that may be relevant to this assessment.

If a director's independent status changes, this should be disclosed and explained to the market in a timely fashion.

**Recommendation 2.2:** The chair should be an independent director.

**Commentary and guidance**

**Role of chair**

The chair is responsible for leadership of the board and for the efficient organisation and conduct of the board's functioning.

The chair should facilitate the effective contribution of all directors and promote constructive and respectful relations between directors and between board and management.

Where the chair is not an independent director, it may be beneficial to consider the appointment of a lead independent director.

The role of chair is demanding, requiring a significant time commitment. The chair's other positions should not be such that they are likely to hinder effective performance in the role.

<sup>14</sup> The relationships affecting independent status in Box 2.1 are adapted from the definition of independence given by Corporate Governance, A Guide for Fund Managers and Corporations – Blue Book, Investment and Financial Services Association, 2004, at www.ifsa.com.au.

<sup>16</sup> For this purpose a "substantial shareholder" is a person with a substantial holding as defined in section 9 of the Corporations Act.

<sup>20</sup> These are directorships required to be disclosed by law, and any other directorships relevant to an assessment of independence.

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Recommendation 2.3: The roles of chair and chief executive officer should not be exercised by the same individual.

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Commentary and guidance

There should be a clear division of responsibility at the head of the company.

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The division of responsibilities between the chair and the chief executive officer should be agreed by the board and set out in a statement of position or authority.

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The chief executive officer should not go on to become chair of the same company. A former chief executive officer will not qualify as an "independent" director unless there has been a period of at least three years between ceasing such employment and serving on the board.

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Recommendation 2.4: The board should establish a nomination committee.

Commentary and guidance

*Purpose of the nomination committee*

A board nomination committee is an efficient mechanism for examination of the selection and appointment practices of the company.

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Ultimate responsibility for these practices, however, rests with the full board, whether or not a separate nomination committee exists.

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For smaller boards, the same efficiencies may not be derived from a formal committee structure. Companies without a nomination committee should have board processes in place which raise the issues that would otherwise be considered by the nomination committee.

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*Charter*

The nomination committee should have a charter that clearly sets out its roles and responsibilities, composition, structure, membership requirements and the procedures for inviting non-committee members to attend meetings.

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The terms of reference of the nomination committee should allow it to have access to adequate internal and external resources, including access to advice from external consultants or specialists.

*Composition of nomination committee*

The nomination committee should be structured so that it:

- consists of a majority of independent directors
- is chaired by an independent director
- has at least three members.

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*Responsibilities*

Responsibilities of the committee should include recommendations to the board about:

- the necessary and desirable competencies of directors,
- review of board succession plans
- the development of a process for the evaluation of the performance of the board, its committees and directors,
- the appointment and re-election of directors.

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*Selection and appointment process and re-election of directors*

A formal and transparent procedure for the selection, appointment and re-appointment of directors to the board helps promote investor understanding and confidence in that process.

Important issues to be considered as part of the process include:

- Director competencies

In order to be able to discharge its mandate effectively the board should comprise directors possessing an appropriate range of skills and expertise. The nomination committee should consider implementing a plan for identifying, assessing and enhancing director competencies.

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An evaluation of the range of skills, experience and expertise on the board is important when considering new candidates for nomination or appointment. Such an evaluation enables identification of the particular skills that will best increase board effectiveness.

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- Board renewal

Board renewal is critical to performance, and directors should be conscious of the duration of each director's tenure in succession planning.

The nomination committee should consider whether succession plans are in place to maintain an appropriate balance of skills, experience and expertise on the board.

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- Composition and commitment of the board

The board should be of a size and composition that is conducive to making appropriate decisions. The board should be large enough to incorporate a variety of perspectives and skills, and to represent the best interests of the company as a whole rather than of individual shareholders or interest groups. It should not, however, be so large that effective decision-making is hindered.

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Individual board members should devote the necessary time to the tasks entrusted to them. All directors should consider the number and nature of their directorships and calls on their time from other commitments.

In support of their candidature for directorship or re-election, non-executive directors should provide the nomination committee with details of other commitments and an indication of time involved. Prior to appointment or being submitted for re-election non-executive directors should specifically acknowledge to the company that they will have sufficient time to meet what is expected of them.

The nomination committee should regularly review the time required from a non-executive director, and whether directors are meeting that requirement. Non-executive directors should inform the chair, and the chair of the nomination committee before accepting any new appointments as directors.

- Election of directors

The names of candidates submitted for election as directors should be accompanied by the following information to enable shareholders to make an informed decision on their election:

- biographical details, including competencies and qualifications and information sufficient to enable an assessment of the independence of the candidate
- details of relationships between:
  - the candidate and the company, and
  - the candidate and directors of the company
- directorships held <sup>20</sup>
- particulars of other positions which involve significant time commitments
- the term of office currently served by any directors subject to re-election

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- any other particulars required by law.<sup>21</sup>

~~Non-executive directors should be appointed for specific terms subject to re-election and to the ASX Listing Rules and Corporations Act provisions concerning removal of a director.~~

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Re-appointment of directors should not be automatic.

Recommendation 2.5: Companies should disclose the process for evaluating the performance of the board, its committees and individual directors.

#### Commentary and Guidance

The performance of the board should be reviewed regularly against appropriate measures.

#### Induction and education

Induction procedures should be in place to allow new directors to participate fully and actively in board decision-making at the earliest opportunity.

To be effective, new directors need to have a good deal of knowledge about the company and the industry within which it operates. An induction program should be available to enable new directors to gain an understanding of:

- the company's financial, strategic, operational and risk management position
- the rights, duties and responsibilities of the directors
- the roles and responsibilities of senior executives
- the role of board committees.

Directors should have access to continuing education to update and enhance their skills and knowledge.

This should include education concerning key developments in the company and in the industry and environment within which it operates.

#### Access to information

The board should be provided with the information it needs to effectively discharge its responsibilities effectively.

Senior executives should supply the board with information in a form and timeframe, and of a quality that enables the board to discharge its duties effectively. Directors are entitled to request additional information where they consider such information necessary to make informed decisions.

#### The board and the company secretary

The company secretary plays an important role in supporting the effectiveness of the board by monitoring that board policy and procedures are followed, and coordinating the timely completion and despatch of board agenda and briefing material.

It is important that all directors have access to the company secretary.

The appointment and removal of the company secretary should be a matter for decision by the board as a whole.

The company secretary should be accountable to the board, through the chair, on all governance matters.

Recommendation 2.6: Companies should provide the information indicated in the Guide to reporting on Principle 2.

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<sup>21</sup> The Guidelines for notices of meeting at [www.asx.com.au](http://www.asx.com.au) are designed to assist communication with shareholders and contain guidance on framing resolutions for the election of directors.

## Guide to reporting on Principle 2

The following material should be included in the corporate governance statement in the annual report:

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- the skills, experience and expertise relevant to the position of director held by each director in office at the date of the annual report
- the names of the directors considered by the board to constitute independent directors and the company's materiality thresholds
- the existence of any of the relationships listed in Box 2.1 and an explanation of why the board considers a director to be independent, notwithstanding the existence of these relationships
- a statement as to whether there is a procedure agreed by the board for directors to take independent professional advice at the expense of the company
- the period of office held by each director in office at the date of the annual report
- the names of members of the nomination committee and their attendance at meetings of the committee, or where a company does not have a nomination committee, how the functions of a nomination committee are carried out
- whether a performance evaluation for the board, its committees and directors has taken place in the reporting period and whether it was in accordance with the process disclosed
- an explanation of any departures from Recommendations 2.1, 2.2, 2.3, 2.4, 2.5 or 2.6.

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The following material should be made publicly available, ideally by posting it to the company's website in a clearly marked corporate governance section:

- a description of the procedure for the selection and appointment of new directors and the re-election of incumbent directors,
- the charter of the nomination committee or a summary of the role, rights, responsibilities and membership requirements for that committee
- the board's policy for the nomination and appointment of directors.

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### Application of Principle 2 in relation to trusts and externally managed entities

References to "board" and "directors" should be applied as references to the board and directors of the responsible entity of the trust and to equivalent roles in respect of other externally managed entities.

There may be technical conflict in implementing the Recommendations that a director be independent and that the chair be an independent director or a lead independent director, where the manager or responsible entity is a wholly-owned subsidiary of a parent company such as a fund manager and all the directors are employees of the parent. This should be discussed and clarified in any explanation of departure from the Recommendations included in the corporate governance statement in the annual report.

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¶ Note also that Part 5C.5 of the Corporations Act in relation to compliance committees for trusts provides under section 601JA(1) that a responsible entity must establish a compliance committee if less than half the directors of the responsible entity are external directors.

Principle 3:  
Promote ethical and responsible decision-making

Companies should actively promote ethical and responsible decision-making.

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To make ethical and responsible decisions companies should not only comply with their legal obligations, but should also consider the reasonable expectations of their stakeholders including: shareholders, employees, customers, suppliers, creditors, consumers and the broader community in which they operate. It is a matter for the board to consider and assess what is appropriate in each company's circumstances. It is important for companies to demonstrate their commitment to appropriate corporate practices and decision making.

Companies should:

- clarify the standards of ethical behaviour required of the board, senior executives and all employees and encourage the observance of those standards
- comply with their legal obligations and have regard to the reasonable expectations of their stakeholders
- publish the policy concerning the issue of board and employee trading in company securities and in associated products, including products which operate to limit the economic risk of those securities.

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Recommendation 3.1: Companies should establish a code of conduct and disclose the code or a summary of the code as to:

- the practices necessary to maintain confidence in the company's integrity
- the practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders
- The responsibility and accountability of individuals for reporting and investigating reports of unethical practices.

Commentary and guidance

Purpose of a code of conduct

Good corporate governance ultimately requires people of integrity. Personal integrity cannot be regulated. However, investor confidence can be enhanced if the company clearly articulates acceptable practices for directors, senior executives and employees.

The board has a responsibility to set the ethical tone and standards of the company. Senior executives have a responsibility to implement practices consistent with those standards. Company codes of conduct which state the values and policies of the company can assist the board and senior executives in this task and complement the company's risk management practices.

Application of a code of conduct

Companies should formulate policies on the appropriate behaviour of directors, senior executives and employees. Companies should also encourage the integration of these policies into company-wide management practices. A code of conduct, supported by appropriate training and monitoring of compliance with the code are effective ways to guide the behaviour of directors, senior executives and employees and demonstrate the commitment of the company to ethical practices. Companies should ensure that training on the code of conduct is updated on a regular basis.

Companies should consider making advisers, consultants and contractors aware of the company's expectations as set out in the code of conduct.

It is not necessary for companies to establish a separate code for directors and senior executives. Depending on the nature and size of the company's operations, the code of conduct for directors and senior executives may stand alone or be part of the corporate code of conduct.

Suggestions for the content of a code of conduct are set out in Box 3.1.

**Box 3.1: Suggestions for the content of a code of conduct**

Companies may find it useful to consider the following matters when formulating a code of conduct:

1. Give a clear commitment by the board and senior executives to the code of conduct. This is often linked to statements about the aspirations or objectives of the company, its core values, and its views about the expectations of shareholders, employees, customers, suppliers, creditors, consumers and the broader community.
2. Detail the company's responsibilities to shareholders and the financial community generally. This might include reference to the company's commitment to delivering shareholder value and how it will do this, and the company's approach to accounting policies and practices, and disclosure.
3. Specify the company's responsibilities to shareholders, employees, customers, suppliers, creditors, consumers and the broader community. This might include reference to standards of product quality or service, commitments to fair value, fair dealing and fair trading and the safety of goods produced.
4. Describe the company's approach to the community. This might include environmental protection policies, support for community activities, and donation or sponsorship policies.
5. Articulate the company's responsibilities to the individual. This might include the company's privacy policy, and its policy on the use of privileged or confidential information.
6. Outline the company's employment practices. This might include reference to occupational health and safety, employment opportunity practices, special entitlements above the statutory minimum, employee security trading policies, training and further education support policy, practices on drug and alcohol usage and policies on outside employment.
7. Describe the company's approach to business courtesies, bribes, facilitation payments, inducements and commissions. This might include how the company regulates the giving and accepting of business courtesies and facilitation payments and prevents the offering and acceptance of bribes, inducements and commissions and the misuse of company assets and resources.
8. State the measures the company follows to promote active compliance with legislation affecting its operations wherever it operates. This might include stating whether the company's policy is to comply with Australian or local legal requirements regarding employment practices, responsibilities to the community and responsibilities to the individual, particularly if the host country follows materially different standards than those prescribed by Australian law or international protocols.
9. Specify how the company handles actual or potential conflicts of interest. This might include reference to how the company manages situations where the interest of a private individual interferes or appears to interfere with the interests of the company as a whole and how the company prevents directors, senior executives and employees from taking improper advantage of property, information or position, or opportunities arising from these, for personal gain or to compete with the company.
10. Identify measures the company follows to encourage the reporting of unlawful or unethical behaviour and to actively promote ethical behaviour. This might include reference to how the company protects those, such as whistleblowers who report violations in good faith, and its processes for dealing with such reports.<sup>23</sup>
11. Describe the means by which the company monitors and ensures compliance with its code.

**Recommendation 3.2:** Companies should establish a policy concerning trading in company securities by directors, senior executives, and employees and disclose the policy or a summary of that policy.

**Commentary and guidance**

Public confidence in the company can be eroded if there is insufficient understanding about the company's policies governing trading by "potential insiders". The law prohibits insider trading, and the Corporations Act and the ASX Listing Rules require disclosure of any trading undertaken by directors or their related entities in the company's securities.<sup>24</sup>

<sup>23</sup> For guidance on the provision of a whistleblowing service, see Australian Standards on *Whistleblowing Programs for Entities (AS 8004)*.

<sup>24</sup> ASX Listing Rule 3.19A regarding disclosure by the company of directors' notifiable interests within five business days.

Companies should note that as at July 2007 the Government proposes amending Section 205G of the Corporations Act

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<#>3. Confidentiality - restricting the use of non-public information except where disclosure is authorised or legally mandated.¶  
4. Fair dealing - by all employees with the company's customers, suppliers, competitors and employees.¶  
5. Protection of and proper use of the company's assets - protecting and ensuring efficient use of assets for legitimate business purposes.¶  
6. Compliance with laws and regulations - active promotion of compliance.¶  
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For the purpose of this policy a "potential insider" is a person likely to possess inside information and includes the directors, the chief executive officer, or equivalent, the chief financial officer, or equivalent, staff members who are involved in material transactions concerning the company, and any other member of staff who is likely to be in the possession of inside information.

"Inside information" means information concerning a company's financial position, strategy or operations and any other information which a reasonable person might consider, if it were made public, would be likely to have a material impact on a decision to buy or sell a company's securities.<sup>25</sup>

Where companies establish a code of conduct and trading policy, they should also introduce appropriate compliance standards and procedures to ensure that the policy is properly implemented. There should also be an internal review mechanism to assess compliance and effectiveness. This review may involve an internal audit function.

Suggestions for the content of a trading policy are set out in Box 3.2.

**Box 3.2: Suggestions for the content of a trading policy**

Companies may find it useful to consider the following matters when formulating a trading policy:

1. Clearly identify the directors, officers, employees or group of employees who are restricted from trading ("designated officers").<sup>26</sup>
2. Identify and raise awareness about the prohibitions under the law and the requirements of the policy. This should include an awareness that it is inappropriate for the designated officer to procure others to trade when the designated officer is precluded from trading, and an awareness of the need to enforce confidentiality against external advisers.
3. Require designated officers to provide notification to an appropriate senior member of the company, for example, in the case of directors, to the chair, of intended trading, including entering into transactions or arrangements which operate to limit the economic risk of their security holdings in the company. No prior notification is needed for dividend reinvestment plans and other corporate actions open to all shareholders.<sup>27</sup>
4. Require subsequent confirmation of the trading that has occurred.
5. Identify whether trading windows or black-outs are used and if so, details of their application.
6. Specify whether there is any discretion to permit trading by designated officers in specific circumstances, for example, financial hardship, details of such circumstances, and the basis upon which discretion is applied.
7. Specify whether the company prohibits designated officers from trading in financial products issued or created over the company's securities by third parties, or trading in associated products.
8. Specify that the company prohibits designated officers from entering into transactions in associated products which operate to limit the economic risk of security holdings in the company over unvested entitlements.
9. Specify whether the policy applies to the securities of other companies of which the designated officer has inside knowledge because of their position with the company.

Where a company makes any representations about the alignment of a director's or senior executive's interests, the company should take into account the extent to which that director or senior executive has an economic interest in the relevant securities.<sup>28</sup>

**Recommendation 3.3:** Companies should provide the information indicated in the Guide to reporting on Principle 3.

**Deleted:** In the interests of investor confidence, companies should consider complementing these requirements with a formal policy governing trading practices.¶

¶ For the purpose of this policy a "potential insider" is a person likely to possess inside information and includes the directors, the chief executive officer (or equivalent), the chief financial officer (or equivalent), staff members who are involved in material transactions concerning the company, and any other member of staff who is likely to be in the possession of inside information.¶

¶ "Inside information" is information concerning the company's financial position, strategy or operations, which, if made public, would be likely to have a material impact on the price of the company's securities.¶

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regarding disclosure by directors of their notifiable interests. The proposed amendment would reduce the timeframe for disclosure from 14 days to two days. There is also a proposal to remove the Listing Rule.

<sup>25</sup> Companies should be aware of the relevant provisions of the Corporations Act.

<sup>26</sup> Anyone coming into possession of inside information has obligations under to comply with the law relating to insider trading.

<sup>27</sup> The recommended disclosure is of the designated officer's effective exposure under their security holdings as a result of these transactions or arrangements.

<sup>28</sup> This will prevent the company making misleading representations about alignment of interests.

**Deleted:** <sup>28</sup> This will prevent the company making misleading representations about alignment of interests.

## Guide to reporting on Principle 3

An explanation of any departure from Recommendations 3.1, 3.2 or 3.3 should be included in the corporate governance statement in the annual report.

The following material should be made publicly available, ideally by posting it to the company's website in a clearly marked corporate governance section:

- any applicable code of conduct or a summary
- the trading policy or a summary of its main provisions.

### Application of Principle 3 in relation to trusts and externally managed entities

References to "directors" and "employees" of a company should be applied as references to directors and employees of the responsible entity, and the relevant trading is in securities of the trust and to equivalent roles in respect of other externally managed entities. The trading policy should refer to the securities or units of the listed entity.

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*Code of Conduct for Chief Financial Officers*, Group of 100, December 2002. [www.group100.com.au](http://www.group100.com.au). Further guidance may be found at [www.csaust.com](http://www.csaust.com) and [www.companydirectors.com.au](http://www.companydirectors.com.au).¶  
*ASX Listing Rule 3.19A*: regarding disclosure by the company of directors' notifiable interests within five business days.¶

Principle 4:  
Safeguard integrity in financial reporting

Companies should have a structure to independently verify and safeguard the integrity of their financial reporting.

This requires companies to put in place a structure of review and authorisation designed to ensure the truthful and factual presentation of the company's financial position. The structure would include, for example:

- review and consideration of the financial statements by the audit committee
- a process to ensure the independence and competence of the company's external auditors.

Such a structure does not diminish the ultimate responsibility of the board to ensure the integrity of the company's financial reporting.

Recommendation 4.1: The board should establish an audit committee.

Commentary and guidance

Purpose of the audit committee

A board audit committee is an efficient mechanism for focusing on issues relevant to the integrity of the company's financial reporting.

Ultimate responsibility for the integrity of a company's financial reporting rests with the full board whether or not a separate audit committee exists.<sup>29</sup>

For smaller boards, the same efficiencies may not be derived from a formal committee structure. Companies without an audit committee should have board processes in place which raise the issues that would otherwise be considered by the audit committee. If there is no audit committee, it is particularly important that companies disclose how their alternative approach assures the integrity of the financial statements of the company and the independence of the external auditor, and why an audit committee is not considered appropriate.

Importance of the audit committee

The existence of an independent audit committee is recognised internationally as an important feature of good corporate governance.

ASX Listing Rule 12.7 requires that an entity included in the S&P All Ordinaries Index at the beginning of its financial year have an audit committee during that year. If an entity is in the top 300 of that Index it must follow the Recommendation below on the composition, operation and responsibilities of the audit committee.<sup>30</sup>

Recommendation 4.2: The audit committee should be structured so that it:

- consists only of non-executive directors
- consists of a majority of independent directors<sup>31</sup>
- is chaired by an independent chair, who is not chair of the board
- has at least three members.

<sup>29</sup> It is desirable that all members of the board be financially literate.

<sup>30</sup> See Note 2.

<sup>31</sup> For further guidance on the concept of an independent director, refer to Box 2.1 and to Recommendation 2.1.

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Recommendation 4.1: Require the chief executive officer (or equivalent) and the chief financial officer (or equivalent) to state in writing to the board that the company's financial reports present a true and fair view, in all material respects, of the company's financial condition and operational results and are in accordance with relevant accounting standards. ¶

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Commentary and guidance¶

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This statement is complemented by the statement required in recommendation 7.2 relating to the underlying risk management system.¶

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Commentary and guidance

Composition of the audit committee

The audit committee should be of sufficient size, independence and technical expertise to discharge its mandate effectively.

Importance of independence

The ability of the audit committee to exercise independent judgement is vital. International practice is moving towards an audit committee comprised of only independent directors<sup>32</sup>.

Technical expertise

The audit committee should include members who are all financially literate (that is, be able to read and understand financial statements); at least one member should have relevant qualifications and experience, (that is, should be a qualified accountant or other finance professional with experience of financial and accounting matters); and some members should have an understanding of the industry in which the entity operates.

It is preferable that the chair of the committee be independent.

**Recommendation 4.3:** The audit committee should have a formal charter.

Commentary and guidance

Charter

The charter should clearly set out the audit committee's role and responsibilities, composition, structure and membership requirements and the procedures for inviting non-committee members to attend meetings.

The audit committee should be given the necessary power and resources to meet its charter. This will include rights of access to management, rights to seek explanations and additional information and access to auditors, internal and external, without management present.

Responsibilities

The audit committee should review the integrity of the company's financial reporting and oversee the independence of the external auditors.

Meetings

The audit committee should meet often enough to undertake its role effectively.

The audit committee should keep minutes of its meetings and these should ordinarily be included in the papers for the next full board meeting after each audit committee meeting.

Reporting

The audit committee should report to the board. The report should contain all matters relevant to the committee's role and responsibilities, including:

- assessment of whether external reporting is consistent with committee members' information and knowledge and is adequate for shareholder needs
- assessment of the management processes supporting external reporting
- procedures for the selection and appointment of the external auditor and for the rotation of external audit engagement partners
- recommendations for the appointment or, if necessary, the removal of the external auditor
- assessment of the performance and independence of the external auditors. Where the external auditor provides non-audit services, the report should state whether the audit committee is satisfied that provision of those services has not compromised the auditor's independence.

<sup>32</sup> For example, IFSA adopts this position see, *Corporate Governance, A Guide for Fund Managers and Corporations* – Blue Book, Investment and Financial Services Association, 2004 at [www.ifsa.com.au](http://www.ifsa.com.au).

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- assessment of the performance and objectivity of the internal audit function
- the results of the committee's review of risk management and internal control systems. Principle 7 provides further guidance on this matter
- recommendations for the appointment, or if necessary, the dismissal of the head of internal audit.

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Recommendation 4.4: Companies should provide the information indicated in the Guide to reporting on Principle 4.

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### Guide to reporting on Principle 4

The following material should be included in the corporate governance statement in the annual report:

- the names and qualifications of those appointed to the audit committee and their attendance at meetings of the committee, or, where a company does not have an audit committee, how the functions of an audit committee are carried out
- the number of meetings of the audit committee
- explanation of any departures from Recommendations 4.1, 4.2, 4.3 or 4.4.

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The following material should be made publicly available, ideally by posting it to the company's website in a clearly marked corporate governance section:

- the audit committee charter
- information on procedures for the selection and appointment of the external auditor, and for the rotation of external audit engagement partners.

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### Application of Principle 4 in relation to trusts and externally managed entities

References to "board" and "directors" should be applied as references to the board and directors of the responsible entity of the trust and to equivalent roles in respect of other externally managed entities.

It is recognised that for a trust to convene an audit committee as required by the Recommendations, and to convene a compliance committee as may be required by the law, may create an overlap and an administrative burden - the two committees will serve substantively similar purposes. Trusts that are required under the law to convene a compliance committee may wish to consider using the compliance committee to also serve the function of the audit committee, with any necessary adaptations in accordance with the Recommendations.

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Deleted: Refer also to section 601JA(2) of the Corporations Act that sets out the criteria for independence of a director of a responsible entity.

Principle 5:  
Make timely and balanced disclosure

Companies should promote timely and balanced disclosure of all material matters concerning the company.

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Companies should put in place mechanisms designed to ensure compliance with the ASX Listing Rule requirements such that:

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- all investors have equal and timely access to material information concerning the company - including its financial position, performance, ownership and governance
- company announcements are factual and presented in a clear and balanced way. "Balance" requires disclosure of both positive and negative information.

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Recommendation 5.1: Companies should establish written policies designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior executive level for that compliance and disclose those policies or a summary of those policies.

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Commentary and guidance

There should be vetting and authorisation processes designed to ensure that company announcements:

- are made in a timely manner
- are factual
- do not omit material information
- are expressed in a clear and objective manner that allows investors to assess the impact of the information when making investment decisions.

Suggestions for the content of these policies are set out in Box 5.1.

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**Box 5.1: Continuous disclosure policies and procedures**

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Companies may find it useful to consider the following matters when formulating continuous disclosure policies:

- the type of information that needs to be disclosed
- internal notification and decision-making concerning the disclosure obligation
- the roles and responsibilities of directors, officers and employees of the company in the disclosure context; in particular, who has primary responsibility for ensuring that the company complies with its disclosure obligations and who is primarily responsible for deciding what information will be disclosed
- promoting understanding of compliance
- monitoring compliance
- measures for seeking to avoid the emergence of a false market in the company's securities
- safeguarding confidentiality of corporate information to avoid premature disclosure
- media contact and comment
- external communications such as analyst briefings and responses to shareholder questions.

Deleted: The policies and procedures should address:¶

*Commentary on financial results*

Companies should include commentary on their financial results to enhance the clarity and balance of reporting. This commentary should include information needed by an investor to make an informed assessment of the entity's activities and results.

Deleted: A guide to the use and form of this commentary is contained in the Group of 100's publication *Guide to the Review of Operations and Financial Condition*.  
[www.group100.com.au](http://www.group100.com.au).

ASX Listing Rule 4.10.17 requires a company's annual report to include a review of operations and activities. Although not specifying the contents of that report, the rule endorses the Group of 100 publication, *Guide to Review of Operations and Financial Condition* which is reproduced in ASX Guidance Note 10 - Review of Operations and Activities.

*Eliminating surprise*

Shareholders' concerns about executive payments are often exacerbated by a lack of information concerning core entitlements when they are agreed. This can be alleviated if, for example, the nature of the termination entitlements of

the chief executive officer, or equivalent, is disclosed to the market at the time they are agreed as well as at the time the actual payment is settled.<sup>33</sup>

Recommendation 5.2: Companies should provide the information indicated in the Guide to reporting on Principle 5.

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### Guide to reporting on Principle 5

An explanation of any departures from Recommendations 5.1 or 5.2 should be included in the corporate governance statement in the annual report.

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The policies or a summary of those policies designed to guide compliance with Listing Rule disclosure requirements should be made publicly available, ideally by posting them to the company's website in a clearly marked corporate governance section.

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a summary of the policies and procedures designed to guide compliance with Listing Rule disclosure requirements.

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*Better Disclosure for Investors - Guidance Rules*, Australian Securities and Investments Commission, 2000.¶  
*Best Practice Guidelines for Communication between Listed Entities and the Investment Community*, Australasian Investor Relations Association, August 2001.¶  
*Guidance Note 8 - Continuous Disclosure: Listing Rule 3.1*, Australian Stock Exchange, January 2003.¶

<sup>33</sup>Companies should note that entering into employment agreements with senior executives, or obligations under those agreements falling due, may trigger a continuous disclosure obligation under Listing Rule 3.1. See Companies Update 1 May 2003 *Continuous Disclosure and Chief Executive Officer Remuneration* at [www.asx.com.au](http://www.asx.com.au).

Principle 6:  
Respect the rights of shareholders

Companies should respect the rights of shareholders and facilitate the effective exercise of those rights.

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Companies should empower their shareholders by:

- communicating effectively with them
- giving them ready access to balanced and understandable information about the company and corporate proposals
- making it easy for them to participate in general meetings.

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Recommendation 6.1: Companies should design a communications policy for promoting effective communication with shareholders and encouraging their participation at general meetings and disclose their policy or a summary of that policy.

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Commentary and guidance

Publishing the company's policy on shareholder communication will help investors understand how to obtain access to relevant information about the company and its corporate proposals.

*Electronic communication*

Companies should consider how best to take advantage wherever practicable of new technologies that provide:

- opportunities for more effective communications with shareholders
- improved access for shareholders unable to be physically present at meetings.

See Box 6.1 for suggestions on how to improve shareholder participation and enhance market awareness through electronic means.

*Meetings*

Companies should consider how to use general meetings effectively to communicate with shareholders and allow reasonable opportunity for informed shareholder participation.

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The ASX Corporate Governance Council has developed guidelines for improving shareholder participation through the design and content of notices and through the conduct of the meeting itself.<sup>34</sup>

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*Communication with beneficial owners*

Companies may wish to consider allowing beneficial owners to choose to receive shareholder materials directly; for example, by electronic means.

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*Website*

All companies should have a website and are encouraged to communicate with shareholders via electronic methods. If a company does not have a website it must make relevant information available to shareholders by other means; for example, a company may provide the information on request by email, facsimile or post.

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**Box 6.1: Using electronic communications effectively**

Companies should use their websites to complement the official release of material information to the market. This will enable broader access to company information by investors and stakeholders. Measures companies may consider include:

- placing all relevant announcements made to the market, and related information (for example, information provided to analysts or media during briefings), on the company website after they have been released to ASX

Deleted: Guidelines for improving shareholder participation through the design and content of notices and the conduct of the meeting itself are at www.asx.com.au. They are guidelines only and not reporting requirements.

<sup>34</sup> Guidelines for improving shareholder participation through the design and content of notices and the conduct of the meeting itself are at www.asx.com.au. They are guidelines only and not reporting requirements.

- webcasting or teleconferencing analyst or media briefings and general meetings, or posting a transcript or summary to the website
- placing the full text of notices of meeting and explanatory material on the website - see Guideline 12 in the [Guidelines for notices of meeting at www.asx.com.au](#)
- providing information about the last three years' press releases or announcements plus at least three years of financial data on the website.
- providing information updates to investors by email.

**Recommendation 6.2: Companies should provide the information indicated in the Guide to reporting on Principle 6. Guide to reporting on Principle 6**

An explanation of any departure from Recommendations 6.1 or 6.2 should be included in the corporate governance statement in the annual report.

The company should describe how it will communicate with its shareholders publicly, ideally by posting the information on the company's website in a clearly marked corporate governance section.

**Application of Principle 6 in relation to trusts and externally managed entities**

The annual general meeting is the central forum by which companies can effectively communicate with shareholders, provide them with access to information about the company and corporate proposals, and enable their participation in decision-making. The Corporations Act does not, however, require trusts to hold annual general meetings, although they may do so. Trusts should consider the range of means by which they may achieve the same ends, including the possibility of convening general meetings.

Listed entities that are not required to comply with section 250RA of the Corporations Act should consider the range of means by which they may achieve the same ends.<sup>36</sup> This applies not only to trusts and externally managed entities but also to entities such as foreign incorporated entities. Any such entity should include in its annual report a statement disclosing the extent to which it has achieved the aims of the provisions of section 250RA during the reporting period and give reasons for not doing so.

<sup>36</sup> Section 250RA [Auditor required to attend listed company' AGM] of the Corporations Act makes it an offence for the lead auditor not to attend a listed company's AGM, or arrange to be represented by a suitably qualified member of the audit team who is in a position to answer questions about the audit.

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Deleted: Request the external auditor to attend the annual general meeting and be available to answer shareholder questions about the conduct of the audit and the preparation and content of the auditor's report.¶ ¶ Commentary and guidance¶ ¶ Section 249K of the Corporations Act requires that a company provide its auditor with notice of a general meeting and related communications that a member of the company is entitled to receive.¶ ¶ The auditor is entitled to attend the general meeting and be heard at that meeting on any business item that concerns them in their capacity as auditor
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Principle 7:  
Recognise and manage risk

Companies should establish a sound system of risk oversight and management and internal control.<sup>37</sup>

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Risk management is the culture, processes and structures that are directed towards taking advantage of potential opportunities while managing potential adverse effects.<sup>38</sup>

Risk management should be designed to:

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- identify, assess, monitor and manage risk
- identify material changes to the company's risk profile.<sup>39</sup>

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Risk management can enhance the environment for identifying and capitalising on opportunities to create value and protect established value.

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The company should address risks that could have a material impact on its business (material business risks) as identified by the company's risk management system. The board should regularly review and approve the risk management and oversight policies.

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Recommendation 7.1: Companies should establish policies for the oversight and management and management of material business risks and disclose a summary of those policies.<sup>40</sup>

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Commentary and guidance

Each company will need to determine the "material business risks" it faces. When establishing and implementing its approach to risk management a company should consider all material business risks. These risks may include but are not limited to: operational, environmental, sustainability, compliance, strategic, ethical conduct, reputation or brand, technological, product or service quality, human capital, financial reporting and market-related risks.<sup>41</sup>

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Purpose of the committee¶  
Particularly for larger companies, a committee can be a more efficient mechanism than the full board for focusing the company on risk oversight and management and on internal control. The appropriate board committee may be the audit committee, the risk management committee or other relevant committee.¶  
The existence of a committee should not be seen as implying a fragmentation or diminution of the responsibilities of the board as a whole.¶  
It is recognised that for smaller boards, the same efficiencies may not be apparent from a formal committee structure.¶  
¶  
Policies¶  
The policies should clearly describe the roles and respective accountabilities of the board, audit committee (or other appropriate board committee), management and any internal audit function.¶  
They should include the following components: oversight; risk profile; risk management; compliance and control; and assessment of effectiveness.¶  
¶  
Oversight of the risk management system¶  
It is part of the board's oversight role to oversee the establishment and implementation of the risk management system, and to review at least annually the effectiveness of the company's implementation of that system.¶  
¶

The board is responsible for reviewing the company's policies on risk oversight and management and satisfying itself that management has developed and implemented a sound system of risk management and internal control.<sup>42</sup>

Risk management policies

Risk management policies should reflect the company's risk profile and should clearly describe all elements of the risk management and internal control system and any internal audit function.

When developing risk management policies the company should take into account its legal obligations.<sup>43</sup> A company should also consider the reasonable expectations of its stakeholders. Stakeholders can include: shareholders, employees, customers, suppliers, creditors, consumers and the broader community in which the company operates.

<sup>37</sup> For the purposes of Principle 7 a reference to a "company" will also include references to a "subsidiary" and an "associate" as defined in AASB 128 *Investments in Associates*.

<sup>38</sup> There is a range of guidance available on risk management. Frameworks for risk management include the Australian/New Zealand *Standard for Risk Management* – ANZ 4360 at [www.standards.org.au](http://www.standards.org.au) and COSO *Enterprise Risk Management – Integrated Framework*, published by the Committee of Sponsoring Organisations of the Treadway Commission at [www.coso.org](http://www.coso.org).

<sup>39</sup> Companies should be aware of their obligations under section 299A of the Corporations Act [Annual directors' report – Additional requirement for listed public companies].

<sup>40</sup> The ASX Corporate Governance Council has issued *Supplementary Guidance to Principle 7* which is at [www.asx.com.au](http://www.asx.com.au)

<sup>41</sup> Financial reporting risk is the risk of a material error in the financial statements.

<sup>42</sup> There is a range of guidance available on internal control. Frameworks for internal control include the COSO *Internal Control Integrated Framework* at [www.coso.org](http://www.coso.org). Additional guidance is available through the Institute of Chartered Accountants in England and Wales – *Internal Control, Guidance for Directors on the Combined Code* at [www.icaew.co.uk](http://www.icaew.co.uk) and Australian/New Zealand *Standard for Compliance - ANZ 3806* at [www.standards.org.au](http://www.standards.org.au).

<sup>43</sup> Legal obligations include but are not limited to requirements dealing with trade practices and fair dealing laws, environmental law, privacy law, employment law, occupational health and safety, equal employment and opportunity laws.

Failure to consider the reasonable expectations of stakeholders can threaten a company's reputation and the success of its business operations. Effective risk management involves considering factors which bear upon the company's continued good standing with its stakeholders.

A company's risk management policies should clearly describe the roles and accountabilities of the board, audit committee, or other appropriate board committee, management and any internal audit function.

**Recommendation 7.2:** The board should require management to design and implement the risk management and internal control system to manage the company's material business risks and report to it on whether those risks are being managed effectively. The board should disclose that management has reported to it as to the effectiveness of the company's management of its material business risks.

**Commentary**

Risk management and internal control system

Internal controls are an important element of risk management. Management should design, implement and review the company risk management and internal control system.

As part of its oversight for the risk management and internal control system, the board should review the effectiveness of the implementation of that system at least annually. The board retains responsibility for assessing the effectiveness of the company's systems for management of material business risks. It may be appropriate in the company's circumstances for the board to make additional enquiries and to request assurances regarding the management of material business risks.

Internal audit function

An internal audit function will generally carry out the analysis and independent appraisal of the adequacy and effectiveness of the company's risk management and internal control system. A company should therefore consider having an internal audit function.<sup>44</sup> An alternative mechanism may be used to achieve the same outcome depending on the company's size and complexity and the types of risk involved.

The internal audit function should be independent of the external auditor. The internal audit function and the audit committee should have direct access to each other and should have all necessary access to management and the right to seek information and explanations.

Risk management committee

A board committee is an efficient mechanism for focusing the company on appropriate risk oversight, risk management and internal control. The appropriate committee may be the audit committee, a risk management committee or another relevant committee.

Ultimate responsibility for risk oversight and risk management rests with the full board, whether or not a separate risk management committee exists.

For smaller boards, the same efficiencies may not be derived from a formal committee structure. Companies without a risk management committee should have board processes in place which raise the issues that would otherwise be considered by a risk management committee.

**Recommendation 7.3:** The board should disclose whether it has received assurance from the chief executive officer (or equivalent) and the chief financial officer (or equivalent) that the declaration provided in accordance with section 295A of the Corporations Act is founded on a sound system of risk management and internal control, and that the system is operating effectively in all material respects in relation to financial reporting risks.

**Commentary and guidance**

Unlike Recommendation 7.2 this Recommendation only addresses financial reporting risks directly because the

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*Risk profile*¶  
The risk profile should be a description of the material risks facing the company. Material risks include financial and non-financial matters. ¶  
The risk profile should be regularly reviewed and updated. ¶  
¶

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**Deleted:** for identifying, assessing, monitoring and managing material risk throughout the organisation.¶  
This system will include the company's internal compliance and control systems.¶  
In establishing appropriate procedures management can take into account AS/NZS4360 - Risk Management within the Internal Audit Process, The Institute of Internal Auditors Australia and Standards Australia, 2002. www.standards.com.au and www.iaa.org.au.¶

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A company, particularly a substantial company, is encouraged to have an internal audit function.¶  
¶  
*Internal audit function*¶ (... [29])

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7.2.2 the company's risk (... [33])

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<sup>44</sup> Guidance on the internal audit function is found in the Technical Information and Guidance section at [www.iaa.org.au](http://www.iaa.org.au).

Corporations Act requires a declaration in relation to a listed entity's financial statements by the chief executive officer and/or the chief financial officer.<sup>45</sup>

The integrity of the company's financial reporting depends up on the existence of a sound system of risk oversight and management and internal control. The requirement to provide this assurance encourages management accountability in this area.

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The assurance under this Recommendation forms part of the process by which the board determines the effectiveness of its risk management and internal control systems in relation to financial reporting risks.<sup>46</sup>

Recommendation 7.4: Companies should provide the information indicated in the Guide to reporting on Principle 7.

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### Guide to reporting on Principle 7

The following material should be included in the corporate governance statement in the annual report:

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- explanation of any departures from Recommendations 7.1, 7.2, 7.3 or 7.4.
- whether the board has received the report from management under Recommendation 7.2
- whether the board has received assurance from the chief executive officer (or equivalent) and the chief financial officer (or equivalent) under Recommendation 7.3.

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The following material should be made publicly available, ideally by posting it to the company's website in a clearly marked corporate governance section:

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- a summary of the company's policies on risk oversight and management of material business risks.

### Application of Principle 7 in relation to trusts and externally managed entities

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• a description of the company's risk management policy and internal compliance and control system.¶  
¶

References to "board" and "directors" should be applied as references to the board and directors of the responsible entity of the trust and to equivalent roles in respect of other externally managed entities.

Deleted: It is recognised that for a trust to convene an audit committee as required under the recommendations, and a compliance committee that may be required under the law, may create an overlap and an administrative burden - the two committees will serve substantially similar purposes. Trusts that are required under the law to convene a compliance committee may wish to consider using the compliance committee to also serve the function of the audit committee, with any necessary adaptations in accordance with the best practice recommendations.¶  
Refer also to section 601JA(2) of the Corporations Act, which sets out the criteria for independence of a director of the responsible entity. ¶

<sup>45</sup>Section 295A [Declaration in relation to listed entity's financial statements by chief executive officer and chief financial officer] into Part 2M – Financial Reporting of the Corporations Act. The directors' declaration under s295(4) can now only be made once the directors have received a declaration from the CEO and CFO, or equivalents that: (a) the financial records have been properly maintained, (b) the financial statements comply with accounting standards and (c) the financial statements and notes give a true and fair view. Any company not required to comply with section 295A of the Corporations Act should consider the range of means by which it may achieve the same ends and should include in its annual report a statement disclosing the extent to which it has achieved the aims of section 295A during the reporting period and provide reasons for not doing so.

<sup>46</sup> The G100 has published guidance to assist companies to meet their obligations under Principle 7 in Principle 7 – Guide to Compliance with ASX Principle 7 – Recognise and Manage Risk at [www.groupof100.com.au](http://www.groupof100.com.au).

**Principle 8:**  
Remunerate fairly and responsibly

Companies should ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to performance is clear.

The awarding of remuneration is a key area of focus for investors. When setting the level and structure of remuneration, a company needs to balance its desire to attract and retain senior executives and directors against its interest in not paying excessive remuneration. It is important that there be a clear relationship between performance and remuneration, and that the policy underlying executive remuneration be understood by investors.<sup>47</sup>

**Recommendation 8.1:** The board should establish a remuneration committee.

**Commentary and guidance**

*Purpose of the remuneration committee*

A board remuneration committee is an efficient mechanism for focusing the company on appropriate remuneration policies.

Ultimate responsibility for a company's remuneration policy rests with the full board, whether or not a separate remuneration committee exists.

For smaller boards, the same efficiencies may not be derived from a formal committee structure. Companies without a remuneration committee should have board processes in place which raise the issues that would otherwise be considered by the remuneration committee.

*Charter*

The remuneration committee should have a charter that clearly sets out its role and responsibilities, composition, structure and membership requirements and the procedures for non-committee members to attend meetings.

The terms of reference of the remuneration committee should allow it to have access to adequate internal and external resources, including access to advice from external consultants or specialists.

*Composition of remuneration committee*

The remuneration committee should be structured so that it:

- consists of a majority of independent directors
- is chaired by an independent director
- has at least three members.

*Responsibilities of the remuneration committee*

The responsibilities of the remuneration committee should include a review of and recommendation to the board on:

- the company's remuneration, recruitment, retention and termination policies and procedures for senior executives
- senior executives' remuneration and incentives
- superannuation arrangements
- the remuneration framework for directors<sup>50</sup>.

<sup>47</sup> Note the requirements relating to disclosure of remuneration policy and details in Section 300A of the Corporations Act.

<sup>50</sup> The remuneration framework for directors is often addressed by the nomination committee rather than the remuneration committee.

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**Deleted:** Provide disclosure in relation to the company's remuneration policies to enable investors to understand (i) the costs and benefits of those policies and (ii) the link between remuneration paid to directors and key executives

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Disclosing the remuneration policy is a fundamental requirement for remuneration reporting. The interests of shareholders and the market are best served through a transparent and readily understandable framework for executive compensation and its costs and benefits. ¶

Transparency as to the remuneration policy should be compleme... [34]

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Remuneration policy

The company should design its remuneration policy in such a way that it:

- motivates senior executives to pursue the long-term growth and success of the company.
- demonstrates a clear relationship between senior executives' performance and remuneration.

The remuneration committee may seek input from individuals on remuneration policies, but no individual should be directly involved in deciding their own remuneration.

The remuneration committee should ensure that the board is provided with sufficient information to ensure informed decision-making.

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Recommendation 8.2: Companies should clearly distinguish the structure of non-executive directors' remuneration from that of executive directors and senior executives.

Executive directors' and senior executives' remuneration packages should involve a balance between fixed and incentive pay, reflecting short and long-term performance objectives appropriate to the company's circumstances and goals.

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The Corporations Act requires companies to make detailed disclosure of executive remuneration policies in their remuneration reports which are subject to an advisory vote by shareholders. Under the Listing Rules and the Corporations Act companies are not generally required to obtain shareholder approval for equity-based incentive plans for senior executives who are not directors.

However, companies may find it useful to submit to shareholders proposed equity-based incentive plans which will involve the issue of new shares to senior executives prior to implementing them. This communication is directed at providing the board with a timely assurance that a plan is reasonable.<sup>51</sup> Companies may also consider reporting to shareholders on whether equity-based remuneration payments involving the issue of new shares to senior executives are made pursuant to plans approved by shareholders.

Guidelines on an appropriate framework for determining executive directors' and senior executives' remuneration packages are contained in Box 8.1.

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**Box 8.1: Guidelines for executive remuneration packages**

Most executive remuneration packages will involve a balance between fixed and incentive pay.<sup>52</sup> Companies may find it useful to consider the following components in formulating packages:

- 1. Fixed remuneration**  
This should be reasonable and fair, taking into account the company's legal and industrial obligations and labour market conditions, and should be relative to the scale of business. It should reflect core performance requirements and expectations.
- 2. Performance-based remuneration**  
Performance-based remuneration linked to clearly specified performance targets can be an effective tool in promoting the interests of the company and shareholders. Incentive schemes should be designed around appropriate performance benchmarks that measure relative performance and provide rewards for materially improved company performance.
- 3. Equity-based remuneration**  
Appropriately designed equity-based remuneration, including stock options, can be an effective form of remuneration when linked to performance objectives or hurdles.

Equity-based remuneration has limitations and can contribute to 'short-termism' on the part of senior executives. Accordingly, it is important to design appropriate schemes. The terms of such schemes should clearly prohibit entering into transactions or arrangements which limit the economic risk of participating in

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<sup>51</sup> Under Section 211 of the Corporations Act benefits that are "reasonable remuneration" are an exception to the requirement for member approval for financial benefits to related parties under Section 208 of the Act.

<sup>52</sup> Companies should note that entering into employment agreements with senior executives, or obligations under those agreements falling due may trigger a continuous disclosure obligation under Listing Rule 3.1. See Companies Update 1 May 2003 *Continuous Disclosure and Chief Executive Officer Remuneration* at [www.asx.com.au](http://www.asx.com.au).

unvested entitlements under these schemes.<sup>53</sup> The exercise of any entitlements under these schemes should be timed to coincide with any trading windows under any trading policy established by the company.

#### 4. Termination payments

Termination payments if any for chief executive officers should be agreed in advance, including detailed provisions in case of early termination. There should be no payment for removal for misconduct.

Agreements should clearly articulate performance expectations. Companies should consider the consequences of an appointment not working out, and the costs and other impacts of early termination.

Box 8.2 contains guidelines for appropriate practice in non-executive director remuneration.

#### Box 8.2: Guidelines for non-executive director remuneration

Companies may find it useful to consider the following when considering non-executive director remuneration:

1. Non-executive directors should normally be remunerated by way of fees, in the form of cash, non-cash benefits, superannuation contributions or equity; they should not normally participate in schemes designed for the remuneration of executives.
2. Non-executive directors should not receive options or bonus payments.
3. Non-executive directors should not be provided with retirement benefits other than superannuation.

Recommendation 8.3: Companies should provide the information indicated in the Guide to reporting on Principle 8.

#### Guide to reporting on Principle 8

The following material or a clear cross-reference to the location of the material should be included in the corporate governance statement in the annual report:

- the names of the members of the remuneration committee and their attendance at meetings of the committee, or where a company does not have a remuneration committee, how the functions of a remuneration committee are carried out
- the existence and terms of any schemes for retirement benefits, other than superannuation, for non-executive directors
- an explanation of any departures from Recommendations 8.1, 8.2 or 8.3.

The following material should be made publicly available, ideally by posting it to the company's website in a clearly marked corporate governance section:

- the charter of the remuneration committee or a summary of the role, rights, responsibilities and membership requirements for that committee
- a summary of the company's policy on prohibiting entering into transactions in associated products which limit the economic risk of participating in unvested entitlements under any equity-based remuneration schemes.

#### Application of Principle 8 in relation to trusts and externally managed entities

Under the Corporations Act, remuneration and indemnity for costs and expenses of the responsible entity is required to be disclosed in a trust's constitution. This may overlap to an extent with the Recommendations and should be taken into account by trusts.

Externally managed entities should disclose a summary of any management agreement terms relating to management fees or the equivalent, including performance fees, including a clear cross reference to the location of this material.

<sup>53</sup> Where a company makes any representations about the alignment of a senior executive's interests, the company should take into account the extent of that senior executive's alignment of interest based on any disclosure under the company trading policy.

**Deleted:** For guidance as to principles relevant to such design, refer to Executive Share and Option Scheme Guidelines, IFSA Guidance Note, Investment and Financial Services Association, 2000.

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**Deleted:** Consideration must be given to the consequences of an appointment not working out, and to the costs and other impacts of early termination.¶

¶ **Recommendation 9.3:** Clearly distinguish the structure of non-executive directors' remuneration from that of executives.¶

¶ **Commentary and guidance**¶

**Deleted:** 9.3

**Deleted:** Where schemes for retirement benefits for non-executive directors are in place, their existence and terms should be clearly disclosed in the corporate governance section of the annual report, including the provision accrued each year together with the total amount accrued to date. The relevant amount should be disclosed as a component of each participating director's remuneration.¶

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Listed entities that are not required to comply with section 300A of the Corporations Act or Australian Accounting Standard 124 *Related Party Disclosures* should consider the range of means by which they may achieve the same ends and should provide a clear cross-reference to the location of this material.<sup>54</sup>

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<sup>54</sup> Section 300A [Annual Directors' Report – Specific information to be provided by listed companies – particularly Disclosure of remuneration policy and details] and AASB 124 *Related Party Disclosures*.

## **Glossary**

### **board**

Means the directors of a company acting as a board and, in the case of listed trusts and externally managed entities, references to "boards" and "directors" are references to the boards and directors of the responsible entity of the trust and to equivalent roles in respect of other externally managed entities

### **Commentary**

Means the discussion following each Recommendation which is provided for assistance, but does not give rise to a reporting obligation

### **Company**

Means any listed entity and includes listed managed investment schemes (trusts), externally managed entities, listed stapled entities and listed foreign entities. For the purposes of Principle 7, a reference to a "company" will also include references to a "subsidiary" and an "associate" as defined in AASB 128 *Investments in Associates*

### **corporate governance statement**

The separate section of a company's annual report containing the disclosures required under LR 4.10.3 in relation to the extent to which a company has followed the Recommendations. Where the Corporations Act requires particular information to be included in the directors' report a company has the discretion to include a cross-reference to the relevant information in the corporate governance statement in the annual report rather than duplicating the information

### **executive director**

Means a director who is an executive of the company

### **financially literate**

Able to read and understand financial statements

### **Guide to reporting**

Occurs at the end of each Principle and sets out the disclosure obligations of companies against Recommendations contained in the Principle

### **"if not, why not"**

Means the approach to disclosure against Recommendations required for compliance with LR 4.10.3 comprising an explanation of the extent to which an entity has followed Recommendations or its reasons for adopting an alternative corporate governance practice to one contained in a Recommendation. Both following a Recommendation and a statement of reasons why a Recommendation is not followed constitute valid compliance with the Listing Rule

### **independent director**

Has the meaning under the Commentary in Recommendation 2.1

### **material business risks**

Means risks that could have a material impact on a company's business. They can include but are not limited to: operational, environmental, sustainability, compliance, strategic, ethical conduct, reputation or brand, technological, product or service quality, human capital, financial reporting and market-related risks

### **non-executive director**

Means a director who is not an executive of the company

### **Principles**

Means the eight core Principles of corporate governance

### **Recommendations**

Are a reference point for the implementation of the Principles, and form the basis for "if not, why not" reporting under the Guide to Reporting for each Principle

senior executives

Means the senior management team, as distinct from the board, being those who have the opportunity to materially influence the integrity, strategy and operation of the company and its financial performance

shareholders

Includes unitholders of unit trusts

substantial shareholder

For the purposes of Box 2.1, a substantial shareholder is a person with a substantial holding as defined in section 9 of the Corporations Act

summary

Means, in relation to any document, a description of its main provisions in sufficient detail to understand the purpose of the document.

## List of references to further Guidance

### Principle 1

*A Guide to Directors' and Officers' Liability Insurance*, 1st edition, June 2001, C Smith, N Milne, F Morris. Australian Institute of Company Directors.

### Principle 2

*Corporate Practices and Conduct*, 3rd edition, 1995, Australian Institute of Company Directors, Australian Society of Certified Practising Accountants, Business Council of Australia, Law Council of Australia, Institute of Chartered Accountants in Australia and The Securities Institute of Australia also known as the *Bosch Committee* guidelines, after the chair of the working group, Henry Bosch AO.

*Corporate Governance, A Guide for Fund Managers and Corporations – Blue Book*, 5<sup>th</sup> edition, October 2004, Investment and Financial Services Association.

*Chairman of the Board: A Role in the Spotlight*, 2006, Australian Institute of Company Directors.

*Evaluating Board Performance*, 2007, Australian Institute of Company Directors.

*How to Implement a Board Performance Management System*, 2004, Geoff De Lacy and Anne De Lacy.

*How to Review and Assess the Value of Board Subcommittees*, 2005, Geoff De Lacy.

*The Greaves Case and the Responsibilities and Liabilities of a Chairman*, 2006, Australian Institute of Company Directors.

*Corporate Governance and the Role of the Company Secretary*, 3<sup>rd</sup> edition, 2003, Chartered Secretaries Australia at [www.csaust.com](http://www.csaust.com).

*Enhancing Board Performance*, 2005, Chartered Secretaries Australia at [www.csaust.com](http://www.csaust.com).

### Principle 3

AS 8004 *Whistleblowing Protection Programs for Entities*, Standards Australia at [www.standards.com.au](http://www.standards.com.au).

AS 3806-2006: *Compliance programs*, Standards Australia at [www.standards.com.au](http://www.standards.com.au).

*Code of Conduct for Chief Financial Officers*, December 2002, Group of 100 at [www.group100.com.au](http://www.group100.com.au).

*Code of Conduct*, 2005, Australian Institute of Company Directors at [www.companydirectors.com.au](http://www.companydirectors.com.au).

ASX Listing Rule 3.19A: regarding disclosure by the company of directors' notifiable interests within five business days.

### Principle 4

*Audit Committees: Best Practice Guide*, 2<sup>nd</sup> edition, August 2001, Australian Accounting Research Foundation, Institute of Internal Auditors and Australian Institute of Company Directors.

The independence and objectivity of the auditor is considered in Section 290, *APES 110 Code of Ethics for Professional Accountants*, Accounting, Professional and Ethical Standards Board, June 2006 at [www.apesb.org.au](http://www.apesb.org.au).

### Principle 5

[Principles of Good Communications with Shareholders, 2007, Australian Institute of Company Directors at   
www.companydirectors.com.au.](#)

[Company Shareholder Dialogue: Fresh Approaches to Communications between Companies and their Shareholders, 2004, Discussion Paper, Business Council of Australia, Australian Institute of Company Directors and Chartered Secretaries Australia at   
www.bca.com.au.](#)

[Better Disclosure for Investors - Guidance Rules, 2000, Australian Securities and Investments Commission.](#)

[Guide to Review of Operations and Financial Condition, 2003, Group of 100 at   
www.group100.com.au.](#)

[Best Practice Guidelines for Communication between Listed Entities and the Investment Community, 2<sup>nd</sup> edition, May 2006, Australasian Investor Relations Association.](#)

[Principles for Building Better Relations between Listed Entities and Analysts, March 2006, Australasian Investor Relations Association and Financial Services Institute of Australasia.](#)

[Guidance Note 8 - Continuous Disclosure: Listing Rule 3.1, June 2005, Australian Stock Exchange.](#)

[Continuous Disclosure: Listed Public Companies and other Disclosing Entities, 2005, Chartered Secretaries Australia at   
www.csaust.com.](#)

### Principle 6

[Principles of Good communications with Shareholders, 2007, Australian Institute of Company Directors at   
www.companydirectors.com.au.](#)

[Company Shareholder Dialogue: Fresh Approaches to Communications between Companies and their Shareholders, 2004, Discussion Paper, Business Council of Australia, Australian Institute of Company Directors and Chartered Secretaries Australia at   
www.bca.com.au.](#)

### Principle 7

[Supplementary Guidance to Principle 7, The ASX Corporate Governance Council, 2007 at   
www.asx.com.au.](#)

[Frameworks for risk management include the Australian/New Zealand \*Standard for Risk Management\* – ANZ 4360 at   
www.standards.org.au and COSO Enterprise Risk Management – Integrated Framework, published by the Committee of Sponsoring Organisations of the Treadway Commission at   
http://www.coso.org.](#)

[There is a range of guidance available on internal control. Frameworks for internal control include the COSO Internal Control Integrated Framework at   
www.coso.org. Additional guidance is available through the Institute of Chartered Accountants in England and Wales – \*Internal Control, Guidance for Directors on the Combined Code\* at   
www.icaew.co.uk and Australian/New Zealand Standard for Compliance - ANZ 3806 at   
http://www.standards.org.au.](#)

[Guidance on the internal audit function is found in the Technical Information and Guidance section at   
www.iaa.org.au.](#)

[Principle 7 – Guide to Compliance with ASX Principle 7 – Recognise and Manage Risk, 2003, Group of 100 at   
www.group100.com.au.](#)

### Principle 8

[Corporate Governance, A Guide for Fund Managers and Corporations – Blue Book, 5<sup>th</sup> edition, October 2004, Investment and Financial Services Association.](#)

[Executive Equity Plan Guidelines, 2007, Australian Institute of Company Directors, Australian Employee Ownership Association and Australian Shareholders' Association at \[www.companydirectors.com.au\]\(http://www.companydirectors.com.au\).](#)

[Employee Share Ownership Plan Guidelines, 2007, Australian Institute of Company Directors, Australian Employee Ownership Association and Australian Shareholders' Association at \[www.companydirectors.com.au\]\(http://www.companydirectors.com.au\).](#)

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**Comparative table of changes to the Principles and Recommendations**

<u>Existing Principle/Recommendation</u>	<u>Revised Principle/Recommendation</u>
<u>Principle 1 – Lay solid foundations for management and oversight</u>	<u>No change</u>
<u>1.1 Formalise and disclose the functions reserved to the board and those delegated to management.</u>	<u>Recommendation 1: Companies should establish the functions reserved to the board and those delegated to senior executives and disclose those functions.</u>
<u>Box 1.1 Content of a director's letter of appointment</u>	<u>Box 1.1 Content of a director's letter upon appointment</u>
	<u>1.2 Companies should disclose the process for evaluating the performance of senior executives.</u>
	<u>1.3 Companies should provide the information indicated in the Guide to reporting on Principle 1.</u>
<u>Principle 2 – Structure the board to add value</u>	<u>No change</u>
<u>2.1 A majority of the board should be independent directors.</u>	<u>No change</u>
<u>Box 2.1 Assessing the independence of directors</u>	<u>Box 2.1 Relationships affecting independent status</u>
<u>2.2 The chairperson should be an independent director.</u>	<u>2.2 The chair should be an independent director.</u>
<u>2.3 The roles of chairperson and chief executive officer should not be exercised by the same individual.</u>	<u>2.3 The roles of chair and chief executive officer should not be exercised by the same individual.</u>
<u>2.4 The board should establish a nomination committee.</u>	<u>No change</u>
	<u>2.4 No change</u>
<u>2.5 Provide the information indicated in Guide to reporting on Principle 2.</u>	<u>2.5 Companies should disclose the process for evaluating the performance of the board, its committees and individual directors.</u>
	<u>2.6 Companies should provide the information indicated in the Guide to reporting on Principle 2.</u>
<u>Principle 3 – Promote ethical and responsible decision making.</u>	<u>No change</u>
<u>3.1 Establish a code of conduct to guide the directors, the chief executive officer (or equivalent), the chief financial officer (or equivalent) and any other key executives as to:</u>	<u>3.1 Companies should establish a code of conduct and disclose the code or a summary of the code as to:</u>
<u>3.1.1 the practices necessary to maintain confidence in the company's integrity</u>	<ul style="list-style-type: none"> <li>• <u>No change</u></li> </ul>
<u>3.1.2 the responsibility and accountability of individuals for reporting and investigating reports of unethical practices.</u>	<ul style="list-style-type: none"> <li>• <u>the practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders</u></li> </ul>
	<ul style="list-style-type: none"> <li>• <u>the responsibility and accountability of individuals for reporting and</u></li> </ul>

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<u>Existing Principle/Recommendation</u>	<u>Revised Principle/Recommendation</u>
	<u>investigating reports of unethical practices.</u>
<u>Box 3.1 Suggestions for the content of a code of conduct</u>	<u>No change</u>
<u>3.2 Disclose the policy concerning trading in company securities by directors, officers and employees.</u>	<u>3.2 Companies should establish a policy concerning trading in company securities by directors, senior executives and employees and disclose the policy or a summary of that policy.</u>
<u>Box 3.2 Suggestions for the content of a trading policy</u>	<u>No change</u>
<u>3.3 Provide the information indicated in Guide to reporting on Principle 3.</u>	<u>3.3 Companies should provide the information indicated in the Guide to reporting on Principle 3.</u>
<u>Principle 4 – Safeguard integrity in financial reporting</u>	<u>No change</u>
<u>4.1 Require the chief executive officer (or equivalent) and the chief financial officer (or equivalent) to state in writing to the board that the company's financial reports present a true and fair view, in all material respects, of the company's financial condition and operational results and are in accordance with relevant accounting standards.</u>	<u>4.1 The board should establish an audit committee.</u>
<u>4.2 The board should establish an audit committee.</u>	<u>4.2 The audit committee should be structured so that it:</u> <ul style="list-style-type: none"> <li><u>• consists only of non-executive directors</u></li> <li><u>• consists of a majority of independent directors</u></li> <li><u>• is chaired by an independent chair, who is not chair of the board</u></li> <li><u>• has at least three members.</u></li> </ul>
<u>4.3 Structure the audit committee so that it consists of:</u> <ul style="list-style-type: none"> <li><u>• only non-executive directors</u></li> <li><u>• a majority of independent directors</u></li> <li><u>• an independent chairperson, who is not chairperson of the board</u></li> <li><u>• at least three members.</u></li> </ul>	<u>4.3 The audit committee should have a formal charter.</u>
<u>4.4 The audit committee should have a formal charter.</u>	<u>4.4 Companies should provide the information indicated in the Guide to reporting on Principle 4.</u>
<u>4.5 Provide the information indicated in Guide to reporting on Principle 4.</u>	<u>See Recommendation 4.4</u>
<u>Principle 5 – Make timely and balanced disclosure</u>	<u>No change</u>
<u>5.1 Establish written policies and procedures designed to ensure compliance with ASX Listing Rule disclosure requirements and to</u>	<u>5.1 Companies should establish written policies designed to ensure compliance with ASX Listing Rule disclosure requirements and to</u>

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<u>Existing Principle/Recommendation</u>	<u>Revised Principle/Recommendation</u>
<u>ensure accountability at a senior management level for that compliance.</u>	<u>ensure accountability at senior executive level for that compliance and disclose those policies or a summary of those policies.</u>
<u>Box 5.1 Continuous disclosure policies and procedures</u>	<u>Box 5.1 Continuous disclosure policies</u>
<u>5.2 Provide the information indicated in Guide to reporting on Principle 5.</u>	<u>5.2 Companies should provide the information indicated in the Guide to reporting on Principle 5.</u>
<u>Principle 6 – Respect the rights of shareholders</u>	<u>No change</u>
<u>6.1 Design and disclose a communications strategy to promote effective communication with shareholders and encourage effective participation at general meetings.</u>	<u>6.1 Companies should design a communications policy for promoting effective communication with shareholders and encouraging their participation at general meetings and disclose their policy or a summary of that policy.</u>
<u>Box 6.1 Using electronic communications effectively</u>	<u>No change</u>
<u>6.2 Request the external auditor to attend the annual general meeting and be available to answer shareholder questions about the conduct of the audit and the preparation and content of the auditor's report.</u>	<u>6.2 Companies should provide the information indicated in the Guide to reporting on Principle 6.</u>
<u>Principle 7 – Recognise and manage risk</u>	<u>No change</u>
<u>7.1 The board or appropriate board committee should establish policies on risk oversight and management.</u>	<u>7.1 Companies should establish policies for oversight and management of material business risks and disclose a summary of those policies.</u>
<u>7.2 The chief executive officer (or equivalent) and the chief financial officer (or equivalent) should state to the board in writing that:</u> <u>7.2.1 the statement given in accordance with best practice Recommendation 4.1 (the integrity of financial statements) is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the board</u> <u>7.2.2 the company's risk management and internal compliance and control system is operating efficiently and effectively in all material respects.</u>	<u>7.2 The board should require management to design and implement the risk management and internal control system to manage the company's material business risks and report to it on whether those risks are being managed effectively. The board should disclose that management has reported to it as to the effectiveness of the company's management of its material business risks.</u>
<u>7.3 Provide the information indicated in Guide to reporting on Principle 7.</u>	<u>7.3 The board should disclose whether it has received assurance from the chief executive officer (or equivalent) and the chief financial officer (or equivalent) that the declaration provided in accordance with section 295A of the Corporations Act is founded on a sound system of risk management and internal control and that the system is operating effectively in all</u>

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<u>Existing Principle/Recommendation</u>	<u>Revised Principle/Recommendation</u>
	<u>material respects in relation to financial reporting risks.</u>
	<u>7.4 Companies should provide the information indicated in the Guide to reporting on Principle 7.</u>
<u>Principle 8 – Encourage enhanced performance</u>	<u>See Principle 1 - Lay solid foundations for management and oversight</u> <u>See Principle 2 - Structure the board to add value</u>
<u>8.1 Disclose the process for performance evaluation of the board, its committees and individual directors, and key executives.</u>	<u>For senior executives see Recommendation 1.2</u> <u>For directors see Recommendation 2.5</u>
<u>Principle 9 – Remunerate fairly and responsibly</u>	<u>Now Principle 8</u>
<u>9.1 Provide disclosure in relation to the company's remuneration policies to enable investors to understand (i) the costs and benefits of those policies and (ii) the link between remuneration paid to directors and key executives and corporate performance.</u>	<u>8.1 The board should establish a remuneration committee.</u>
<u>Box 9.1 Disclosure of remuneration policies and procedures</u>	<u>See section 300A of the Corporations Act and AASB 124 <i>Related Party Disclosures</i></u>
<u>9.2 The board should establish a remuneration committee.</u>	<u>8.2 Companies should clearly distinguish the structure of non-executive directors' remuneration from that of executive directors and senior executives.</u>
<u>Box 9.2 Content of executive remuneration packages</u>	<u>Box 8.1 Guidelines for executive remuneration packages</u>
	<u>Box 8.2 Guidelines for non-executive director remuneration</u>
<u>9.3 Clearly distinguish the structure of non-executive directors' remuneration from that of executives.</u>	<u>See Recommendation 8.2</u>
<u>Box 9.3 Guidelines for non-executive director remuneration</u>	<u>See Box 8.2</u>
<u>9.4 Ensure that payment of equity-based executive remuneration is made in accordance with thresholds set in plans approved by shareholders.</u>	<u>8.3 Companies should provide the information indicated in the Guide to reporting on Principle 8.</u>
<u>9.5 Provide the information indicated in Guide to reporting on Principle 9.</u>	<u>See Recommendation 8.3</u>
<u>Principle 10 – Recognise the legitimate interests of stakeholders.</u>	<u>See Principle 3 – Promote ethical and responsible decision making</u> <u>See Principle 7 – Recognise and manage risk</u>
<u>10.1 Establish and disclose a code of conduct to guide compliance with legal and other obligations to legitimate stakeholders.</u>	<u>See Recommendation 3.1.</u>

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that the ASX Corporate Governance Council believes underlie good corporate governance

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enhanced structures to minimise problems and optimise performance and accountability.

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management and the board

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Keeping pace with the modern risks of business and other aspects of governance requires formal mechanisms that encourage enhanced board and management effectiveness (Principle 8).

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The impact of company actions and decisions is increasingly diverse and good governance recognises the legitimate interests of all stakeholders (Principle 10).

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Justice Owen in the HIH Royal Commission, *The Failure of HIH Insurance Volume 1: A Corporate Collapse and Its Lessons*, Commonwealth of Australia, April 2003 at page xxxiii and Justice Owen, *Corporate Governance – Level upon Layer*, Speech to the 13<sup>th</sup> Commonwealth Law Conference 2003, Melbourne 13-17 April 2003 at page 2.

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Where should disclosure be made?

Specific guidance is given at the end of each principle as to what disclosure the company is required or encouraged to make and where.

In some cases the company is required to set out the relevant disclosure in a separate corporate governance section of the annual report. Where the Corporations Act requires particular information to be included in the directors' report, the company has the discretion to include a cross-reference to the relevant information in the corporate governance section of the annual report rather than replicating that information.

For more general information, there are requirements to make information publicly available, ideally by provision on the company's website. This information should be clearly presented in a dedicated corporate governance information section within the website. The corporate governance section of the annual report should contain appropriate website references, links or instructions to enable shareholders to readily access this information.

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The tenure of each director is important to an assessment of independence. The board should disclose the period of office of each director in the corporate governance section of the annual report.

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*Independent decision-making*  
All directors should bring an independent judgement to bear in decision-making. To facilitate this, there should be a procedure agreed by the board for directors to take independent professional advice if necessary, at the company's expense.

Non-executive directors should consider the benefits of conferring regularly at scheduled sessions without management present. Their discussions can be facilitated by the chairperson or lead

independent director.

### Box 2.1: Assessing the independence of directors

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An independent director is a non-executive director (ie is not a member of management) and:

1. is not a substantial shareholder

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2 of the company or an officer of, or otherwise associated directly with, a substantial shareholder of the company

2. within the last three years has not been employed in an executive capacity by the company or another group member, or been a director after ceasing to hold any such employment

3. within the last three years has not been a principal of a material professional adviser or a material consultant to the company or another group member, or an employee materially associated with the service provided

4. is not a material supplier or customer of the company or other group member, or an officer of or otherwise associated directly or indirectly with a material supplier or customer

5. has no material contractual relationship with the company or another group member other than as a director of the company

6. has not served on the board for a period which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the company

7. is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the company.

Family ties and cross-directorships may be relevant in considering interests and relationships which may compromise independence, and should be disclosed by directors to the board.

The UK Higgs report

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<sup>3</sup> nominates 10 years in relation to director tenure considerations, but has not yet been adopted in the UK. The Council will continue to monitor developments in other jurisdictions in this area.

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, and for the briefing of all directors in relation to issues arising at board meetings.

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It is important that the chairperson

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It is vital that the chairperson commit the time necessary to discharge that role effectively. In that context the number of

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, and time commitment associated with them, should be taken into account.

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### How to achieve best practice

**Recommendation 4.1:** Require the chief executive officer (or equivalent) and the chief financial officer (or equivalent) to state in writing to the board that the company's financial reports present a true and fair

<sup>1</sup> The definition in Box 2.1 is adapted from the definition of independence given by Corporate Governance, A Guide for Fund Managers and Corporations – Blue Book, Investment and Financial Services Association, December 2002. [www.ifsa.com.au](http://www.ifsa.com.au)

<sup>2</sup> For this purpose a "substantial shareholder" is a person with a substantial holding as defined in section 9 of the Corporations Act.

<sup>3</sup> Review of the Role and Effectiveness of Non-Executive Directors, Derek Higgs, January 2003

view, in all material respects, of the company's financial condition and operational results and are in accordance with relevant accounting standards.

### Commentary and guidance

This statement is complemented by the statement required in recommendation 7.2 relating to the underlying risk management system.

#### *Interaction with Corporations Act*

The requirement to make this statement encourages management accountability and provides an underpinning for the statements required by the directors under the Corporations Act in relation to the company's financial reports.

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Particularly for larger companies, an

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verifying and safeguarding

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should not be seen as implying a fragmentation or diminution of the responsibilities of the board as a whole.

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If there is no audit committee, it is particularly important that the company disclose how its alternative approach assures the integrity of the financial statements of the company and the independence of the external auditor, and why an audit committee is not considered appropriate.

Companies within the S&P/ASX All Ordinaries Index are subject to

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The composition, operation and responsibilities of the audit committee

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A detailed guide to the responsibilities of the audit committee is provided in Best Practice Guide - Audit Committees, Auditing & Assurance Standards Board of The Australian Accounting Research Foundation, Institute of Internal Auditors, Australian Institute of Company Directors, 2nd edition, August 2001. [www.aarf.asn.au](http://www.aarf.asn.au).

The independence and objectivity of the auditor is considered in Professional Statement F1 - Professional Independence, The Institute of Chartered Accountants in Australia and CPA Australia 2002, and in Pronouncement 1, "Code of Ethics" of the National Institute of Accountants.

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4.

Section 250T of the Corporations Act requires that if the company's auditor or their representative attends the annual general meeting, the chairperson of that meeting must allow a reasonable opportunity for members to ask questions of the auditor or their representative concerning the conduct of the audit and the preparation and content of the auditor's report.

If the company requests the auditor to attend the annual general meeting, this strengthens the role of the auditor and the auditor's accountability to shareholders.

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4 Section 249V of the Corporations Act.

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explanation of any departures from best practice recommendations 6.1 or 6.2.

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a description of the arrangements the company has to promote communication with shareholders.

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encountered.

A company, particularly a substantial company, is encouraged to have an internal audit function.

#### *Internal audit function*

Guidance on the internal audit function is found in the Technical Information and Guidance section on [www.iaa.org.au](http://www.iaa.org.au).

The audit committee should recommend to the board the appointment and dismissal of any chief internal audit executive.

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The audit committee should oversee the scope of the internal audit and should have access to the internal audit function without the presence of management. In order to enhance the objectivity and performance of the internal audit function, companies should consider a second reporting line from the internal audit function to the board or relevant committee.

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should state to the board in writing that:

7.2.1 the statement given

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best practice recommendation 4.1 (the integrity of financial statements)

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7.2.2 the company's risk management and internal compliance and control system

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<sup>5</sup> and corporate performance.

## **Commentary and guidance**

### *Reporting*

Disclosing the remuneration policy is a fundamental requirement for remuneration reporting. The interests of shareholders and the market are best served through a transparent and readily understandable framework for executive compensation and its costs and benefits.

Transparency as to the remuneration policy should be complemented by full and effective disclosure, in keeping with the spirit and intent of the Corporations Act and the ASX Listing Rules, of the remuneration paid to directors and senior management.

### *Annual disclosure*

The Corporations Act requires annual disclosure by a listed company of the details of the nature and amount of each element of the fee or salary of:

Each director  
each of the five highest-paid officers

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<sup>5</sup> That is, any employee or officer who has the opportunity to materially influence the integrity, strategy and operation of the business and its financial performance.

<sup>6</sup> of the company.

This includes disclosure in respect of non-monetary components such as options. To facilitate consistency and clarity of reporting, Box 9.1 contains content guidelines.

#### **Box 9.1: Disclosure of remuneration policy and procedures**

The corporate governance statement of the annual report should contain the following information concerning remuneration:

1. The broad structure and the objectives of the remuneration policy and its relationship to company performance.
2. The amount of remuneration, and all monetary and non-monetary components, for each of the five highest-paid (non-director) executives during the year (discounting accumulated entitlements), and for all directors. This disclosure would include, for example:
  - salary
  - fees
  - non-cash benefits
  - bonuses accruing in respect of that year, regardless of payment date
  - profit share accruing in respect of that year, regardless of payment date
  - superannuation contributions
  - other payments in relation to termination and retirement from office
  - the value of shares issued and options granted, according to an established and recognised method of valuation
  - sign-on payments.

Disclosure should focus on the remuneration components that are related to continuing employment with the company or other companies in the same group. Accordingly, if an executive has been terminated during the year and the termination and other benefits paid classify that executive as one of the five highest-paid executives, the relevant disclosure should include the five highest-paid executives continuing in employment.

Any loans to executives and directors (other than those made on commercial terms) should be included with this disclosure, including the amount and the interest rate.

Benefits such as motor vehicles, rent, travel and relocation allowances and other benefits should also be included.

Effective disclosure requires valuing the various components and describing the valuation techniques used.

3. Statements on the expected outcomes of the remuneration structures referring to Executive Share and Option Scheme Guidelines, IFSA Guidance Note, Investment and Financial Services Association, 2000.
4. Where discretion is exercised by the board in relation to payment of bonuses, stock options and other incentive payments, a statement about this and explanation of the basis for the exercise of that discretion.

#### *Continuous disclosure*

Entering employment agreements with key executives, or obligations under these agreements falling due, may trigger a continuous disclosure obligation under ASX Listing Rule 3.1. Where this is the case, disclosure to the market should include a summary of the main elements and terms of the agreement, including termination entitlements.

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<sup>6</sup> "Officer" is defined in section 6 of the Corporations Act.

In considering the appropriate matters for disclosure to the market and fostering a constructive relationship with shareholders, the sensitivities of significant payments to key executives should be considered.

*Improving corporate behaviour*

Australia needs a framework for disclosure that will produce sustainable improvements in corporate behaviour concerning remuneration practices. The issues associated with the establishment of such a framework are complex. The right framework requires:

- clarification of the disclosure policy and requirements of the Corporations Act relative to matters such as the value of stock options and disclosure of accruals of termination and other payments
- complementary AASB standards, including finalisation of the proposed AASB standard on director, executive and related-party disclosures
- a careful balance in the amount and type of disclosure, so that its outcome is relevant information to investors, and not simply enhanced market conditions for increasing levels of individual remuneration to the detriment of shareholders.

The enhanced framework for determining, reviewing and reporting on remuneration of directors and executives outlined in this document is a significant step in improving the information available to investors and influencing corporate behaviour. However, the Council has agreed as a matter of priority to examine the need for additional disclosure, including for a wider range of executives.

The Council encourages companies to restore investor confidence by adopting disclosure practices designed to enhance awareness of key aspects of the remuneration framework and its link to performance.

*Eliminating surprise*

Shareholder concern about executive payments is often exacerbated by a lack of information concerning core entitlements when they are agreed. This can be alleviated if, for example, the nature of the termination entitlements of the chief executive officer (or equivalent) is disclosed to the market at the time they are agreed as well as at the time the actual payment is settled.

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which are designed to meet the needs of the company and to enhance corporate and individual performance.

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The existence of a remuneration committee should not be seen as implying a fragmentation or diminution of the responsibilities of the board as a whole.

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*Composition of remuneration committee*

The remuneration committee should:

- consist of a minimum of three members, the majority being independent directors
- be chaired by an independent director.

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packages of senior managementthe company's recruitment, retention and termination policies and procedures for senior management incentive schemes

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**Recommendation 9.4:** Ensure that payment of equity-based executive remuneration is made in accordance with thresholds set in plans approved by shareholders.

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disclosure of the company's remuneration policies referred to in best practice recommendation 9.1 and in Box 9.1

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#### **Further guidance**

*Commission on Public Trust and Private Enterprise - Findings and Recommendations Part 1: Executive Compensation*, The Conference Board, 2002.

*Corporate Governance, A Guide for Fund Managers and Corporations - Blue Book*, Investment and Financial Services Association, December 2002. [www.ifsa.com.au](http://www.ifsa.com.au).

*Executive Share and Option Scheme Guidelines - Guidance Note 12*, Investment and Financial Services Association, 2000. [www.ifsa.com.au](http://www.ifsa.com.au).