

**Principles of
Good Corporate Governance
and
Good Practice
Recommendations**

ASX Corporate Governance Council

Exposure Draft of changes

2 November 2006

The proposed changes to the Principles of Good Corporate Governance and Best Practice Recommendations outlined in the Explanatory Paper, Consultation Paper and Exposure Draft represent ASX Corporate Governance Council's collective view of what should be released for public comment and consultation. The material should not be interpreted as representing the final view of any Council member on any issue.

Foreword

The ASX Corporate Governance Council was formed on 15 August 2002, bringing together 21 groups from disparate business backgrounds and carrying the varying aims and priorities that accompany those constituencies.

Despite their differing perspectives, the Council's overriding mission was commonly held: to develop and deliver an industry-wide, supportable and supported framework for corporate governance which could provide a practical guide for listed companies, their investors, the wider market and the Australian community.

The size, complexity and operations of companies differ, and so flexibility must be allowed in the structures adopted to optimise individual performance. That flexibility must, however, be tempered by accountability - the obligation to explain to investors why an alternative approach is adopted - the "if not, why not?" obligation.

The enhancement of corporate accountability and the adoption of this framework for reporting was a major evolution in corporate governance practice in Australia. The impact on Australian companies must not be underestimated. The ASX Corporate Governance Council is committed to a continuing assessment of the implementation experiences of listed companies and the reactions of investors.

This document is not the final and complete guidance - it is offered as guidance only in the sense that any corporate governance regime must be sufficiently flexible to cope with a constantly changing environment. Just as a healthy and robust business environment evolves with circumstances, so too must any guidelines for corporate governance good practice. The ongoing relevance and effectiveness of these guidelines will be periodically reviewed by the ASX Corporate Governance Council.

As with the ASX Listing Rules, where the spirit and intention outweighs the letter of the law, so must these guidelines be applied: maintaining an informed and efficient market and preserving investor confidence remain the constant imperatives.

Chair
ASX Corporate Governance Council

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.¹ Corporate governance influences how the objectives of the company are set and achieved, how risk is monitored and assessed, and how performance is optimised.

Good 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.

How is good corporate governance achieved?

What constitutes good corporate governance will evolve in the light of the changing circumstances of a company and must be tailored to meet those circumstances. Good practice 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 that the ASX Corporate Governance Council believes underlie good corporate governance (each a Principle). Each Principle is explained in detail, with implementation guidance in the form of good practice recommendations (each a Recommendation).

The 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 enhanced structures to minimise problems and optimise performance and accountability.

The fundamentals

Fundamental to any corporate governance structure is establishing the roles of senior executives and the board (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 9).

Each Principle is of equal importance.

¹ 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 13th Commonwealth Law Conference 2003, Melbourne 13-17 April 2003 at page 2.

Why is it important to Australia?

Demonstrably good corporate governance practices are increasingly 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 that we continue to review those practices to ensure they continue to reflect local and international developments and position Australia at the forefront of good practice.

The ASX Corporate Governance Council

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

- 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 Stock Exchange Limited
- Business Council of Australia
- Chartered Secretaries Australia
- CPA Australia
- Group of 100
- Institute of Actuaries of Australia
- The Institute of Chartered Accountants in Australia
- Institute of Internal Auditors Australia
- Investment and Financial Services Association
- Law Council of Australia
- National Institute of Accountants
- Property Council of Australia
- Securities & Derivatives Industry Association
- Financial Services Institute of Australasia

Disclosure of corporate governance practices (applying the “if not, why not?” approach)

How to approach adoption of the good practice recommendations

The good practice 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 aspirations of good practice for optimising 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 why².

Companies are encouraged 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 Council recognises that the range in size and diversity of companies is significant and that smaller companies may face particular issues in following all Recommendations from the outset. 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 meet good practice, the company is encouraged to prioritise its needs and to set and disclose good practice goals against an indicative timeframe for meeting them.

Disclosure requirements

Under ASX Listing Rule 4.10, companies are required to provide a statement in their annual report disclosing the extent to which they have followed these good practice 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.

What disclosures are necessary?

It is only where a Recommendation is not met or where a disclosure requirement is specifically identified that a disclosure obligation is triggered. Each Recommendation is clearly identified as such. The commentary and guidance that follows each Recommendation does not form part of the Recommendation. It is provided to assist companies to understand the reasoning for the Recommendation, highlight factors which may be relevant for consideration, and make suggestions as to how implementation might be achieved.

² 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 good practice 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.

Where should disclosure be made?

Specific guidance as to what disclosure the company is required or encouraged to make and where such disclosure should appear follows each Principle.

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.

What is the disclosure period?

The change in reporting requirement applies to the company's first financial year commencing after 1 July 2007. Accordingly, where a company's financial year begins on 1 July, disclosure will be required in relation to the financial year 1 July 2007 - 30 June 2008 and will be made in the annual report published in 2008.

Companies are encouraged to make an early transition to the revised good practice Recommendations and are requested to consider reporting by reference to the Recommendations in their corporate reporting for the 2006 - 2007 year.

ASX Corporate Governance Council website

The ASX Corporate Governance Council has established a website to assist companies with regard to these Principles and Recommendations. The site contains links to useful reference material and websites of Council members. It is located at www.asx.com.au/corporategovernance.

Audit committees

Specific requirements apply in relation to audit committees for companies within the S&P/ASX All Ordinaries Index.

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, the composition, operation and responsibility of the audit committee must comply with the Recommendations of the ASX Corporate Governance Council. These are set out in Principle 4.

What entities are affected?

The Recommendations have been articulated to apply to companies and other types of listed entities. Where appropriate, the term "company" is used in the 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 Recommendations for trusts has been

highlighted.

The 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 Council considers it important that listed collective investment vehicles adopt 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 are provided with 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

Three Recommendations have been removed from the revised Principles following the incorporation of the bulk of these Recommendations in the Corporations Act and the Accounting Standards.³ Council considers that the vast majority of listed companies will benefit from removing duplications and overlap between the Principles and the Corporations Act and the Accounting Standards.

Council has therefore amended Principles 6 and 9 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 complied with the provisions of sections 250RA during the reporting period and give reasons for any non-compliance.

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 complied with the section and provide reasons for any non-compliance.

Council encourages these entities to adopt the spirit of the Principles and provide these disclosures.

Improving corporate governance disclosures

The need for greater clarity when providing corporate governance information was one of the key findings of the User Survey of professional and private investors conducted by the Council in late 2005 and released in March 2006. 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

³ 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's 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 300 A [Annual Directors' Report – Specific information to be provided by listed companies – particularly Disclosure of remuneration policy and details] and AASB 124 *Related Party Disclosures*

- a summary statement of whether companies are adopting or exception reporting against the Council's Principles and Recommendations.⁴

The ASX review of corporate governance disclosures in 2005 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.⁵

Council encourages companies to consider these suggestions when reporting.

Monitoring implementation and change

This document represents the second edition of the ASX Corporate Governance Council's views on good corporate governance practices. Corporate governance practices must be evolutionary and be responsive to the information needs of local and international investors. 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 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 Council is most grateful for their input, and for invaluable editorial contributions and assistance.

⁴ See the Survey at www.asx.com.au/supervision/pdf/asx_corporate_governance_summary_march06.

⁵ See *2005 Analysis of corporate governance practice disclosure* at http://www.asx.com.au/supervision/governance/monitoring_compliance.htm

Principle 1:
Lay solid foundations for management and oversight

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

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 shareholders⁶
- ensure a balance of authority so that no single individual has unfettered powers.

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

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. Alternatively there should be a formal statement of delegated authority to senior executives.

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 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 and ratifying 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

⁶ Senior executives include all officers and employees who have the opportunity to materially influence the integrity, strategy and operation of the company and its financial performance.

- approving and monitoring the progress of major capital expenditure, capital management, and acquisitions and divestitures
- approving and monitoring financial and other reporting.

Allocation of individual responsibilities

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

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

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

Box 1.1 Content of a director's letter upon appointment

- 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 and expenses
- Superannuation arrangements
- 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.

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 entitlement on termination. Box 9.1 (Principle 9) provides further guidance 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 previously agreed measurable and qualitative indicators.

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, strategic, operational and risk management position
- the rights, duties and responsibilities of senior executives
- the respective rights, duties, responsibilities and roles of the board and senior executives.

Senior executives 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.

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 section of the annual report:

- an explanation of any departure from Recommendation 1.1, 1.2 or 1.3
- 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 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 be aware of the correlation between external directors and compliance committee requirements in Part 5C.5 of the Corporations Act.

**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.

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:

- 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 directors⁷.

Commentary and guidance

Independent decision making

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

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.⁸ Their discussions can be facilitated by the chair or lead independent director, if any.

Independent directors

An independent director is a non-executive director (that is, not a member of management) 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.

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

Directors considered by the board to be independent should be identified as such in the corporate governance section of the annual report. The board should state its reasons if it considers a director to be independent notwithstanding the existence of relationships listed below 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.⁹

⁷ A series of relationships affecting independent status are set out in Box 2.1.

⁸ At times it may be appropriate for the independent directors to meet without other directors present.

⁹ 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

Box 2.1: Relationships affecting independent status¹⁰

A director should not be regarded as independent if 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 company¹¹
2. is employed, or within the last three years has 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 immediately disclosed and explained to the market.

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 board members 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.¹²

the standard it adopts and makes a general statement that the relevant director meets that standard, investors are better informed about the board's reasoning.

¹⁰ 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

¹¹ For this purpose a "substantial shareholder" is a person with a substantial holding as defined in section 9 of the Corporations Act.

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

Commentary and guidance

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

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 authority.

The chief executive officer should not go on to become chair of the same company.

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 selection and appointment practices of the company.

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

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.

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.

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

Responsibilities

Responsibilities of the committee should include:

- assessment of the necessary and desirable competencies of board members
- review of board succession plans
- evaluation of the performance of the board, its committees and each director
- recommendations for the appointment and re-election of directors.

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.

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.

- 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.

- 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.

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. A non-executive director 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 director 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

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- details of relationships between:
 - the candidate and the company
 - the candidate and directors of the company
- directorships held¹³
- particulars of other positions which involve significant time commitments
- the term of office currently served by any directors subject to re-election
- any other particulars required by law
- term of directorship.¹⁴

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.

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 previously agreed measurable and qualitative indicators.

Induction and education

Induction procedures should be in place to allow new board appointees 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 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.

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 should be entitled to request additional information where they consider such information necessary to make informed decisions.

¹³ These are directorships required to be disclosed by law, and any other directorships relevant to an assessment of independence.

¹⁴ The Guidelines for notices of meeting at www.asx.com.au are designed to assist communication with shareholders and contain guidance on framing resolutions for the election of directors.

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.

Guide to reporting on Principle 2

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

- 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
- 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 and its members 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.

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 nomination committee's policy for the nomination and appointment of directors.

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 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

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the Recommendations included in the corporate governance section of the annual report.

Trusts refer also to section 601JA(2) of the Corporations Act, which sets out the criteria for independence of a director of a responsible entity.

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.

To be successful, companies need to have regard to their legal obligations and the interests of a range of stakeholders including shareholders, employees, business partners, creditors, consumers, the environment and the broader community in which they operate. 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 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.

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

- 3.1.1 the practices necessary to maintain confidence in the company's integrity
- 3.1.2 the practices necessary to take into account their legal obligations and the expectations of their stakeholders
- 3.1.3 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 tone and the ethical standards of the company and to oversee adherence to them. 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 determine their own policies on appropriate behaviour by directors, senior executives and employees. A code of conduct, 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 ensure that advisers, consultants and contractors are made aware of the company's expectations as set out in the code of conduct.

It is not necessary for companies to adopt 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.

A code of conduct should address the issues set out in Box 3.1.

Box 3.1: Suggestions for the content of 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, business partners, creditors, consumers, the environment 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 clients, business partners and consumers. 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 responsibilities 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 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 adopts to promote active compliance with legislation affecting its operations. For company operations outside Australia, particularly in developing countries, the code of conduct should state whether those operations comply with Australian or local legal requirements regarding employment practices, responsibilities to the community and responsibilities to the individual, particularly if the host country adopts lower 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 adopts 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.¹⁵
11. Describe the means by which the company monitors and ensures compliance with its code.

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

¹⁵ For guidance on the provision of a whistleblowing service, see Australian Standards on *Whistleblowing Programs for Entities* (AS 8004).

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.¹⁶

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.

Where companies adopt a code of conduct and trading policy, they should also introduce appropriate compliance standards and procedures to ensure that the policies are 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 such a policy are set out in Box 3.2.

Box 3.2: Suggestions for the content of a trading policy

1. Clearly identify the directors, officers, employees or group of employees who are restricted from trading ("designated officers").
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 the like.¹⁷
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.

¹⁶ ASX Listing Rule 3.19A regarding disclosure by the company of directors' notifiable interests within five business days.

¹⁷ The recommended disclosure is of the designated officer's effective exposure under their security holdings as a result of these transactions or arrangements.

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.¹⁸

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

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 section of 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
- 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 apply to the securities or units of the listed entity.

¹⁸ This will prevent the company making misleading representations about alignment of interests.

**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 financials 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.

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 the composition, operation and responsibilities of the audit committee must comply with the Recommendations below.

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

- consists only of non-executive directors
- consists of a majority of independent directors¹⁹
- is chaired by an independent chair, who is not chair of the board
- has at least three members.

¹⁹ For further guidance on the concept of an independent director, refer to Box 2.1 and to recommendation 2.1.

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 directors²⁰.

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.²¹

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:

²⁰ For example, IFSA adopts this position *Corporate Governance, A Guide for Fund Managers and Corporations* – Blue Book, Investment and Financial Services Association, 2004. www.ifsa.com.au.

²¹ All members of the board should be financially literate.

- 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 removal of an 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
- 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.

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

Guide to reporting on Principle 4

The following material should be included in the corporate governance section of 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.

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.

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.

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.

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

- 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.

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

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.

Box 5.1 contains suggestions for the content of these policies and procedures.

Box 5.1: Continuous disclosure policies and procedures

The policies and procedures should address:

- 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.

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.

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.²²

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

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 section of the annual report.

The policies and procedures 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.

²²Companies 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.

**Principle 6:
Respect the rights of shareholders**

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

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.

Recommendation 6.1: Companies should design and disclose a communications strategy to promote effective communication with shareholders and encourage their participation at general meetings.

Commentary and guidance

Publishing the company's policy on shareholder communication will help investors to access the 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.

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.²³

Communication with beneficial owners

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

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

²³ 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.

- web-casting or tele-conferencing 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.

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.

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 section of the annual report.

The company should make a description of its arrangements for promoting communication with shareholders publicly available, ideally by posting it to 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.²⁴ 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 complied with the provisions of section 250RA during the reporting period and give reasons for any non-compliance.

²⁴ 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.

**Principle 7:
Recognise and manage risk**

Companies should establish a sound system of risk oversight, risk management and internal control.²⁵

Risk management is the culture, processes and structures that are directed towards taking advantage of potential opportunities while managing potential adverse effects.²⁶

A risk management system should be designed to:

- identify, assess, monitor and manage risk
- identify material changes to the company's risk profile.²⁷

This structure can enhance the environment for identifying and capitalising on opportunities to create value.

Risk profile

The board should establish the risk profile. It should set out the company's appetite for risk and have regard to the material business risks faced by the company as identified by the company's risk management system. Material business risks include financial reporting risks and other risks of the types set out below. The risk profile should be regularly updated and reviewed.

Recommendation 7.1: The board should establish policies on risk oversight and management.

Commentary and guidance

As part of its oversight role, the board is responsible for establishing the company's policy on risk, and developing and implementing its system of risk management and internal control.²⁸

Each company will need to determine what "material business risks" it faces. When establishing and implementing its system of risk management a company should consider all material business risks. These risks may include but are not limited to:

- financial reporting risks – the risk of a material error in the financial statements
- other risks, such as operational, environmental, sustainability, compliance, strategic, external, ethical conduct, reputation or brand, technological, product or service quality and human capital which if not properly managed will affect the company.

Risk management policy

The risk management policy should take into account the company's risk profile and should clearly describe all elements of the risk management and internal control systems and any internal audit function.

²⁵ For the purposes of Principle 7 a reference to a "company" will also include references to all controlled entities and material associated companies.

²⁶ 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 and COSO Enterprise Risk Management – Integrated Framework, published by the Committee of Sponsoring Organisations of the Treadway Commission at www.coso.org.

²⁷ Companies should be aware of their obligations under section 299A of the Corporations Act [Annual directors' report – Additional requirement for listed public companies].

²⁸ 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 www.standards.org.au.

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Risks should include all material business risks. The company's risk management policy should take into account its legal obligations and the expectations of its stakeholders.²⁹ These can include: shareholders, employees, business partners, creditors, consumers, the environment and the broader community in which the company operates.

Failure to identify and address the expectations of the community or other 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 and the community.

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

Risk management and internal control system

Management should design, implement and review a risk management system.

As part of its oversight for the design and implementation of the risk management and internal control system, the board should review the effectiveness of the implementation of that system at least annually. Internal control systems are an important element of risk management.

Internal audit function

An internal audit function will generally carry out the analysis of the effectiveness of the risk management and internal control system. A company should therefore consider having an internal audit function.³⁰ 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 audit committee should recommend to the board the appointment, and if necessary the dismissal of the head of internal audit.

The internal audit function should be independent of the external auditor. The internal audit function should report to the audit committee and should have all necessary access to management and the right to seek information and explanations.³¹

The audit committee should oversee the scope of the internal audit and should have access to the head of internal audit without management present.

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.

²⁹ Including but not limited to requirements dealing with trade practices and fair dealing laws, environmental, privacy law, employment law, occupational health and safety, equal employment and opportunity laws.

³⁰ Guidance on the internal audit function is found in the Technical Information and Guidance section at www.iaa.org.au.

³¹ Despite the reporting line to the audit committee, the internal audit function is generally employed by the company.

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 7.2: The chief executive officer (or equivalent) and the chief financial officer (or equivalent) should state to the board in writing that the statement given in accordance with section 295A of the Corporations Act is founded on a sound system of risk management and internal control which implements the policies adopted by the board in relation to financial reporting risks, and that the system is operating effectively in all material respects.³²

Commentary and guidance

The integrity of the company's financial reporting depends on the existence of a sound system of risk oversight, risk management and internal control. The requirement to make this statement encourages management accountability in this area.³³

The sign-off under this Recommendation forms part of the process by which the company determines the effectiveness of these systems in relation to financial reporting risks.³⁴

Recommendation 7.3: The chief executive officer (or equivalent) and other responsible senior executives should state to the board in writing that there is a sound system of risk management and internal control which implements the policies adopted by the board in relation to material business risks other than those covered by Recommendation 7.2, and that the system is operating effectively in all material respects.³⁵

Commentary and guidance

As part of its oversight responsibility for risk, the board retains responsibility for assessing the effectiveness of its systems with respect to material business risks which are not covered by Recommendation 7.2. It may be appropriate in the company's circumstances for the board to make additional inquiries and to request additional senior executives to sign off on its other material business risks.

Each company should determine management accountability for sign-off on its other material business risks. These sign-offs should be aligned with responsibility and authority. Senior executives should be conscious of the need to obtain appropriate assurances to support these sign-offs.

Possible Recommendation 7.[4]: Subject of attached Consultation Paper.

³² 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 they may achieve the same ends and should include in its annual report a statement disclosing the extent to which it has complied with the provisions of section 295A during the reporting period and provide reasons for any non-compliance.

³³ Insert reference to appropriate Guidance on ASX or other web site when available.

³⁴ The G100 has published guidance to assist companies to meet their obligations under *Principle 7 – Guide to Compliance with ASX Principle 7 – Recognise and Manage Risk* at www.groupof100.com.au.

³⁵ Which senior executives in addition to the chief executive officer should provide these sign-offs will be a matter to be determined by each individual board.

Recommendation 7.[5]: Companies should provide the information indicated in the Guide to reporting on Principle 7.

Guide to reporting on Principle 7

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

- explanation of any departures from best practice recommendations 7.1, 7.2 or 7.3 [.or 7.4 if introduced]
- whether the board has received the statement in writing from the chief executive officer (or equivalent) and the chief financial officer (or equivalent) under Recommendation 7.2
- whether the board has received the statement in writing from the chief executive officer (or equivalent) and other responsible senior executives under Recommendation 7.3
- where the board receives any qualified statement from management, the fact of the qualified statement and appropriate explanatory information should be disclosed.

A description of the company's risk management policy, internal control system and any internal audit function should be made publicly available, ideally by posting it to the company's website in a clearly marked corporate governance section.

Application of Principle 7 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.

Note the material in Principle 8 has been relocated to Principles 1 and 2.

**Principle 9:
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.³⁶

Recommendation 9.1: 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 only of non-executive directors
- 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

³⁶ Note the requirements relating to disclosure of remuneration policy and details in Section 300A of the Corporations Act.

- superannuation arrangements
- the remuneration framework for directors³⁷.

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.

Commentary and guidance

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.

Recommendation 9.2: Companies should clearly distinguish the structure of non-executive directors' remuneration from that of senior executives.

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.

Guidelines on an appropriate framework for determining senior executives' remuneration packages are contained in Box 9.1.

Box 9.1: Guidelines for executive remuneration packages

Most executive remuneration packages will involve a balance between fixed and incentive pay.³⁸

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

³⁷ The remuneration framework for directors is often addressed by the nomination committee rather than the remuneration committee.

³⁸ 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.

such schemes should clearly prohibit entering into transactions or arrangements which limit the economic risk of participating in unvested entitlements under these schemes.³⁹

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.

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

Box 9.2 contains guidelines for appropriate practice in non-executive director remuneration.

Box 9.2: Guidelines for 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 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 9.3:** Companies should ensure that payment of equity-based executive remuneration is made in accordance with thresholds set in plans approved by shareholders.– See Explanatory Paper for discussion of Council’s views on this Recommendation]

Recommendation 9.4: Companies should provide the information indicated in the Guide to reporting on Principle 9.

Guide to reporting on Principle 9

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

- the company’s remuneration policies referred to in Recommendations 9.1 and 9.2 and Boxes 9.1 and 9.2
- 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 9.1, 9.2, 9.3 or 9.4 or Boxes 9.1 or 9.2.

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

³⁹ The vesting of any entitlements under these schemes should be timed to coincide with any trading windows under a trading policy adopted by the company for the purpose of Recommendation 3.2.

- 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 9 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.

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.⁴⁰

⁴⁰ Section 300A [Annual Directors' Report – Specific information to be provided by listed companies – particularly Disclosure of remuneration policy and details] and Australian Accounting Standard 124 *Related Party Disclosures*.

Note the material in Principle 10 has been relocated to Principles 3 and 7.

Guidelines for notices of meeting

1. Notices of meeting must be honest, accurate and not misleading. Relevant information should not be withheld or presented in a manner designed to mislead shareholders or the market as a whole.
2. Notices must clearly state and, where necessary, explain, the nature of the business of the meeting. They should be prepared in accordance with the following:
 - 2.1 If the resolutions are mandated by the Corporations Act, the company's constitution or the ASX Listing Rules, explanatory notes on each resolution should be provided to shareholders.
 - 2.2 A notice of meeting must comply with the relevant principles of the Corporations Act, including the requirements of sections 249L and 249Q, the common law and the ASX Listing Rules. Section 249L requires a notice of meeting to state the general nature of the meeting's business and section 249Q requires that a meeting of a company's shareholders must be held for a "proper purpose".
3. Notices must set a reasonable time and place for the meeting. Accordingly:
 - 3.1 Reasonable notice must be given. Section 249HA of the Corporations Act requires that at least 28 days notice be given of a meeting.
 - 3.2 Meetings should be held during normal business hours and at a place convenient for the greatest possible number of shareholders to attend. Usually this place would be in the city where the head office of the company is situated or where the majority of individual shareholders reside. Companies may also periodically hold meetings in other places where a significant number of shareholders reside.
 - 3.3 Companies should use their best endeavours to use relevant technology to enable a maximum number of shareholders to attend and participate (as far as technology effectively allows) at meetings.
4. Notices should encourage shareholders' participation either through direct voting or the appointment of proxies. Accordingly:
 - 4.1 The notice of meeting should include a clear reference to the shareholders' rights to appoint a proxy, or where the constitution so provides, to cast a direct vote which is not dependent on the actions or attendance of an appointee.
 - 4.2 Companies should consider allowing shareholders to lodge direct votes or proxies electronically, subject to the adoption of satisfactory authentication procedures.
 - 4.3 Companies should encourage shareholders appointing a proxy to consider how they wish to direct the proxy to vote. That is, whether the shareholder wishes the proxy to vote "for" or "against", or abstain from voting on, each resolution, or whether to leave the decision to the appointed proxy after discussion at the meeting. If the instruction is to abstain from voting, companies should state whether such votes will be counted in computing the required majority on a poll.
 - 4.4 Voting forms should be drafted in such a way as to ensure the shareholder clearly understands how the chairperson of the meeting intends to vote undirected proxies.
 - 4.5 Companies are encouraged to take guidance from the Chartered Secretaries Australia best practice direct voting and proxy form available on that organisation's website, www.csaust.com.
5. Companies should adopt best practice drafting methods for notices of meeting. These include:
 - using plain English to clearly and simply communicate relevant information
 - avoiding legal archaisms such as "aforesaid", "abovementioned", "hereafter", "hereinafter", "hereunder", "herewith", "thereby" and "pursuant"
 - avoiding unnecessary repetition
 - employing a structure and format that ensures readability and ease of understanding by shareholders; this would include making use of layout elements such as:
 - appropriate spacing, indenting, highlighting, headings and numbering
 - a uniform and easily legible font
 - correspondingly sequential treatment of resolutions in any explanatory statements.

6. Companies should combine or “bundle” resolutions in a notice of meeting only in limited circumstances and in accordance with the following guidelines:
 - 6.1 Companies should avoid “bundling” resolutions unless the resolutions are interdependent and linked so as to form one significant proposal. An example of an appropriately bundled resolution is one that incorporates a number of uncontroversial changes to a company’s constitution or the adoption of a new constitution, or approving a scheme of arrangement.
 - 6.2 Where resolutions are “bundled”, the company should ensure the notice clearly explains the primary purpose of the bundled resolution and the material implications of each of its components.
 - 6.3 The following categories of resolution should not be bundled, but always be dealt with as separate items of business, each with a distinct explanation provided.
 - a. To issue options with participation rights, under Listing Rule 6.20.3.
 - b. To issue unquoted options with exercise price variation terms not in accordance with Listing Rule 6.22.2, under Listing Rule 6.22.3.
 - c. To change options under Listing Rules 6.23.2 or 6.23.4.
 - d. To approve an issue under an employee incentive scheme, under Listing Rule 7.2 Exception 9(b), where directors have an interest.
 - e. To approve a transaction with, or issue of securities to, a person in a position of influence under Listing Rules 10.1 (acquisition and disposal of substantial assets), 10.11 (issues of securities to related parties), 10.14 (issues of securities to related parties under an employee incentive scheme), 10.17 (non-executive directors’ remuneration) or 10.19 (termination benefits).
 - f. To approve the terms of issue of preference shares not provided for in the company’s constitution (section 254A(2) Corporations Act), or a change to the company’s constitution that has the same effect.
 - g. To issue a new class of shares not already provided for in the company’s constitution (section 246C(5) Corporations Act), or a change to the company’s constitution that has the same effect.
 - h. To approve a buy-back (sections 257C or 257D Corporations Act).
 - i. To approve the giving of financial assistance (section 260B Corporations Act).
 - j. To appoint or remove directors - each candidate for appointment or removal will require a separate resolution (see guidelines 7 and 8 below).
 - k. Other resolutions in relation to which a director or senior executive has an interest.

This list is not exhaustive; bundling of resolutions should always be considered by reference to the general guidelines set out above.
7. Companies should give clear guidance in notices of meeting containing resolutions for the election of directors, as follows:
 - 7.1 Companies should ensure that each candidate for election be considered separately in a distinct resolution, except as contemplated by 7.2.
 - 7.2 Where the number of candidates for election exceeds the number of available positions on the board, the notice should provide clear guidance on the voting method by which the successful candidates will be selected at the meeting as well as the method to be used for the counting of votes.
 - 7.3 The views of candidates standing for election as directors without the support of the board should fairly and equitably represent the views of candidates .
8. Companies should give clear guidance in notices of meeting containing resolutions for the removal of directors.
 - 8.1 Companies should ensure that each candidate for removal be considered separately in a distinct resolution, and that the notices of meeting fairly and equitably represents the views of the director.
 - 8.2 Companies should be aware that they are required to circulate to all shareholders any written statement provided by a director named in a removal resolution under section 203D(4) of the Corporations Act representing his or her views on the proposal.
9. Companies should ensure notices give clear guidance on directors’ recommendations on resolutions.
 - 9.1 Where recommendations are specifically required, notices should contain adequate representation of the views of all assenting and dissenting directors on specific resolutions. Notices

should make it clear whether represented views are those of an executive director, a non-executive director or an independent director. The notice should present a balanced view on the merits of the proposal.

9.2 Companies would not be expected to present the contrary view in a notice of meeting where directors unanimously support a resolution, but the notice of meeting should, nevertheless, present a balanced view and be forthcoming about any significant disadvantages.

9.3 Guidance on directors' recommendations should be placed at the end of the explanatory note on each resolution.

10. Companies should give particular attention to notices containing complex resolutions.

10.1 Examples of complex resolutions include those requiring an independent expert's report under the Corporations Act takeover provisions or ASX Listing Rule 10.1, those seeking to amend companies' constitutions in respect of proportional takeovers, and resolutions seeking to alter companies' capital structures.

10.2 Notices containing such resolutions should always include a "short form" explanatory statement setting out concisely and clearly the nature of the meeting business and its ramifications for the company.

10.3 Companies should encourage independent experts to preface their reports with a concise executive summary of their findings. Companies should not provide their own summaries of independent experts' findings in explanatory statements.

11. Companies should ensure notices give clear guidance on shareholders' conflicts of interest to the extent that they are known to the company and clearly state which shareholders will be excluded from voting or have their votes disregarded.

11.1 Any conflicts of interest of directors and their associates and senior executives should be clearly outlined. The Corporations Act and ASX Listing Rules contain specific provisions outlining those parties who may be excluded from voting on a resolution in which they may have an interest or receive a benefit disproportionate to other shareholders.

11.2 The question of who may be excluded from voting or whose votes will be disregarded can be an important factor in a shareholder's determination whether to attend a meeting or appoint a proxy. Best practice would require voting exclusion statements to be contained in the notice itself and be located immediately adjacent to the relevant resolution.

11.3 It is quite acceptable, but not essential, for voting exclusion information to be also contained in any explanatory statement.

12. Companies should endeavour to send notices of meeting to shareholders by electronic means if requested, and should place the full text of notices and accompanying explanatory material on the company website. Companies should also consider distributing explanatory material by other means, so that shareholders who do not have access to the Internet and other forms of electronic communication are not disadvantaged. By allowing shareholders to receive notices of meeting and annual reports by electronic means and vote electronically, a company can provide shareholders with more immediate access to the documents and a more convenient method of voting. It will also reduce printing and distribution costs.

12.1 Companies should encourage shareholders to request that notices of meeting be sent to them by electronic means on an "opt-in" basis. Shareholders must be able to change that election at any time, and have the right to request a paper version of a document that has been sent electronically.

12.2 Companies are required by the ASX Listing Rules to release full notice documentation to the ASX Companies Announcements Office.

12.3 In addition, companies should place this material on their website in a prominent and accessible position for shareholders and other market participants who may be considering an investment in the company, or should refer to the ability to download the notice from ASX's website, www.asx.com.au.