



# CORPORATE GOVERNANCE GUIDELINES

A GUIDE FOR SUPERANNUATION TRUSTEES TO MONITOR LISTED AUSTRALIAN COMPANIES

AUGUST 2005



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## INTRODUCTION

Superannuation forms a central plank of government retirement incomes policy. Superannuation funds pursue the objective of maximising members' wealth at retirement through application of prudent investment practices.

A significant proportion of a typical superannuation fund's investments is held in domestic and overseas equities. Therefore, the success and long-term viability of publicly listed Corporations have a direct impact on the value of superannuation funds' investments and, ultimately, members' retirement income. It has been widely accepted that poor governance practices pose a threat to corporate performance, thus potentially destroying shareholder value and jeopardising members' financial interests.

While corporate governance activism does not prevent corporate failure or collapse, it can reduce the risk of corporate failure and thereby potentially protect and enhance members' wealth in the long-term. The exercise of voting rights represents the most visible avenue available to Trustees to exert influence over corporate governance practices.

The Australian Council of Superannuation Investors ("ACSI") first developed these Corporate Governance Guidelines in March 2003 as a supplement to existing regulatory and industry standards. The ultimate aim was to provide Trustees of superannuation funds with a benchmark to assess corporate governance practices of listed investee companies. These updated August 2005 Guidelines reflect the addition of refinements considered necessary by Trustees in light of their experiences of corporate governance issues since 2003.

The Guidelines represent a set of practices that Corporations should follow in conducting their business, and reinforce the accountability of Corporate Boards and management teams to shareholders. ACSI believes, however, that rules and regulations alone are insufficient to instil ethical standards of corporate conduct and deliver the best protection to stakeholders. The essential ingredients of an ethical governance culture within a Corporation are an ethical, competent and collegiate board and an ethical management culture supported by professional staff throughout the organisation.

Compliance with rules, regulations and guidelines alone, will not be enough to prevent corporate governance failures.

Corporations need to develop and support cultures fostering commitment to shareholder value creation, business integrity and creativity, transparency and continuous disclosure.

These Corporate Governance Guidelines were formulated with the assistance of ACSI members and will be reviewed on an ongoing basis and will be updated at least every two years. It is anticipated that the Guidelines will be utilised by a number of superannuation funds in respect of proxy voting and engagement with listed Australian Corporations.

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## 1. PROMOTING GOOD GOVERNANCE

The community expects Boards of Directors (“the Boards”) to formulate and apply high standards of corporate governance behaviour.

A Board should articulate the Corporation’s commitment to corporate governance by developing a charter or code on corporate governance and ethics.

Such a statement should confirm compliance with relevant Corporations Acts, regulations, ASX Listing Rules on corporate governance and generally accepted accounting practices and standards, but should also articulate the Corporation’s commitment to ethical standards in business which supplement these regulatory requirements, including relevant global standards. Accordingly, Corporations are encouraged to apply and report on how such a charter or code is applied at all levels of the Corporation.

The Board should establish a process to ensure that corporate governance issues, especially corporate governance failures and weaknesses, are properly and regularly evaluated and managed by the Corporation.

## 2. THE CORPORATE BOARD

The Board is required to be responsible for the management and direction of a Corporation. An integral responsibility of the Board is to review, ratify and oversee the implementation of the Corporation’s business strategies.

When undertaking their responsibilities, the entire Board and each individual member of the Board, must apply themselves in a manner that is consistent with their responsibility to the Corporation and shareholders.

Such a responsibility requires Directors to:

- > ensure that the Corporation complies with all applicable laws;
- > act in the best interests of the Corporation, its shareholders and stakeholders;
- > use their powers for proper purposes;
- > not limit their discretionary powers;
- > avoid actual and potential conflicts of interest.

It is critical that a board is comprised of individuals who have a high degree of competency, integrity, skill and experience to discharge their duties and responsibilities.

### *2.1 Board Responsibilities*

The Board is entrusted to oversee the Corporation’s business and to formulate, in conjunction with management, the Corporation’s policies. A Board must therefore ensure it is adequately informed about key business issues and is properly equipped to encourage management to strive for above average performance in the Corporation.

The Board is the manager of the company in the absence of the owners and cannot delegate the management function itself. Executives of the company are exercising delegated powers, subject to the ultimate responsibility of the Directors.

Some of the key responsibilities of a Board include:

- > exercising independent judgement over company strategy, performance, resources and standard of conduct and ethics;
- > reviewing, ratifying and overseeing the implementation of the Corporation's business strategies;
- > the selection, appointment and performance management of the Chief Executive Officer (CEO) and other principal senior executives, and the determination of remuneration arrangements and definition of authorities;
- > developing, maintaining and approving CEO succession plans;
- > properly reviewing the Corporation's accounts and certifying that they comply with Australian accounting standards and represent a true and fair view of the affairs of the Corporation;
- > ensuring the maintenance of financial and ethical integrity, including the approval of budgets;
- > establishing and reviewing key financial performance benchmarks;
- > overseeing the Corporation's system of internal control and disclosure;
- > ensuring that proper accountability and systems are in place so that shareholders and stakeholders are informed in accordance with continuous disclosure obligations;
- > ensuring that key developments are properly announced and that prospectuses and reports to shareholders are produced in accordance with regulatory requirements;
- > reviewing and assessing the Board's and each individual Director's performance;
- > undertaking the selection of nominees for election to the Board; and
- > ensuring continuity of corporate learning, renewal, evolution and succession.

The scope of the Board's responsibilities should be documented in writing and shared with management of the Corporation.

### *2.2 Familiarity and Capacity to Oversee Corporate Operations*

Directors should ensure that they are independently familiar with the Corporation's operations and do not rely exclusively on information provided to them by executive management and their advisers.

Each Director should be able, and prepared, to devote sufficient time and effort to his/her duties as a Director.

Boards should convey to prospective and current Directors their general expectations about the workload associated with a directorship on the Board.

Prospective or current Directors should inform the Board of their external commitments which may impact on their capacity to properly fulfil Board responsibilities. This includes full and part-time employment or other directorships that they may hold for profit and not-for-profit organisations.



The Board, when appointing a Director, will ultimately have due regard to the reasonable expectations and commercial interests of the Corporation. It must determine whether a prospective or existing Director is capable of discharging his/her duties to the Corporation, in light of other directorships he/she holds. This will involve such considerations of time constraints, work complexity and workloads.

In general terms, it would be prudent if a Director did not hold more than four directorships in ASX-listed Corporations. However, it is recognised that a Director's capacity to properly discharge his/her responsibilities will be assessed by investors on a 'case by case' basis.

A CEO of an ASX-listed Corporation may add value as a Non-Executive Director of another listed Corporation Board. This can, subject to the CEO managing their primary responsibilities as CEO, enhance his/her understanding and insight into Director duties and Board responsibilities.

### **3. BOARD COMPOSITION**

The Board should be comprised of Directors who are able to work together effectively to lead a viable, profitable and efficient Corporation. Boards should actively seek to harness experience and skills, time and commitment available in the community from people with diverse backgrounds, taking into account age, cultural and business backgrounds and gender.

There should be full disclosure by the Corporation of each Director's expertise and experience.

A Board should be comprised of a sufficient number of Directors capable as a group of fulfilling all Board-related functions.

According to ACSI research, Board sizes of the top 100 ASX companies for 2001 ranged between three and 17, with the average Board size being nine.

ACSI considers that the size of the Board should be sufficient to ensure that there is an adequate number of skilled and Independent Non-Executive Directors on the Board.

A Board should have in place a succession planning policy for sourcing new and replacing outgoing Directors.

#### *3.1 Independent Non-Executive Directors*

A Board's capacity to effectively apply scrutiny over the activities of the Corporation and its officers is directly affected by factors, including the composition of the Board and the extent to which it is comprised of a sufficient number of independent and skilled Directors.

Corporations should, therefore, promote and support the role of independent and skilled Non-Executive Directors who are engaged with the company and who can exercise independence of judgement.

An Independent Non-Executive Director is expected to make decisions on the merits of the subject before the Board, and not be affected by other extraneous considerations or influences. Therefore, a person who is regarded as an Independent Non-Executive Director is expected to be able to make decisions in the best interests of the Corporation in a manner that is independent of management and free of any business or other relationships that could materially interfere with - or could reasonably be perceived to materially interfere with their judgement.

Boards more effectively fulfil their supervisory and advisory functions by bringing an independent perspective to bear on issues. Independent Non-Executive Directors perform a pivotal role in this regard.

A Board should be comprised of a majority of Independent Non-Executive Directors who are sufficiently motivated and equipped to fulfil the function of independent scrutiny of the Corporation's activities.

### *3.2 Definition of Independence*

ACSI recognises that independence is determined predominantly by an individual's character and integrity. These cannot be objectively assessed by shareholders on a consistent basis and, therefore, written guidelines may not always be applicable or sufficient to address particular circumstances.

An Independent Non-Executive Director of a listed Corporation generally should:

- > not be a substantial shareholder of the Corporation. In this context, "substantial" is defined as a shareholding of 5% or more of the total number of votes attached to voting shares in the Corporation as defined under the Corporations Act. This also includes an officer of a substantial shareholder of the Corporation;
- > not be a representative of a substantial or founding shareholder;
- > not have been employed within the last three years in an executive capacity by the Corporation or an associated entity of the Corporation;
- > not be a principal or employee of a professional adviser to the Corporation or a related entity;
- > not have been a principal or employee of a professional adviser to the Corporation or a related entity in the last three years;
- > not be a substantial supplier or customer of the Corporation or another group member;
- > not have a material contractual relationship with the Corporation or another group member other than as a Director of the Corporation;
- > be free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the Independent Non-Executive Director's ability to act in the best interests of the Corporation;
- > not participate in the same share option or performance-related remuneration schemes that apply to executives within the Corporation;
- > not hold other directorships that potentially give rise to a conflict of interest or otherwise impede the proper discharge of his/her Director responsibilities;
- > not serve as a Director or employee of a Corporation in which the Corporation has a notifiable holding<sup>1</sup>;
- > not receive fees for services to the Corporation of a level which is indicative of significant involvement in the Corporation's affairs or which are significant in relation to salaries received by Directors;

Footnote 1: Shareholding of 5% or more



- > not serve as an executive Director or employee of, or have a notifiable holding in, a significant competitor of the Corporation;
- > not be related through blood, marriage or equivalent to other Non-Independent Directors, senior executives or advisers to the Corporation; and
- > not benefit from any related party transaction.

ACSI will consider on a case by case basis, whether the length of tenure of a Director impacts on his/her independence.

In circumstances where the independent status of a Director is altered, then shareholders and the market should be notified of this changed position.

### *3.3 Substantial or Founding Shareholders*

Substantial or founding shareholders, who are either members of a Board or nominate specific persons as Directors, may perform an important role in the oversight of a Corporation and can make important contributions to Corporations. Whilst recognising their position, it is important that a Board outlines the checks and balances in place to ensure that all shareholder interests are properly taken into account.

It is recognised that Independent Non-Executive Directors should play a distinctive role and take the lead where potential conflicts of interest arise. Independent Non-Executive Directors in such circumstances need to have the qualities to not act as mere “rubber stamps” for Non-Independent Directors.

### *3.4 Related Party Transactions*

Related party transactions must be disclosed, together with the means by which the relevant Director or Directors managed their conflict(s) of interest during the Board’s consideration and decision relating to the transaction.

Investors are entitled to seek such explanations in order to satisfy themselves that the Board’s decision in the matter was made fully in the best interests of the company.

The ASX Listing Rule definition of a “Related Party” provides a useful guide for investors. A related party in relation to a person includes:

- (i) his or her spouse, de facto spouse, parent, child or a spouse or de facto spouse of that person;
- (ii) an entity controlled by one or more of the persons referred to in paragraph (i);
- (iii) an entity that he or she controls;
- (iv) a person who acts in concert with anyone referred to above;
- (v) a person who was a related party in the previous six months.

Corporations should ensure that they properly disclose all related party transactions in accordance with the Corporations Act and ASX Listing Rule requirements.

#### **4. INDEMNITY AND LIABILITY OF DIRECTORS**

The Corporation should indemnify Directors for reasonable legal expenses for actions brought in consequence of the exercise of judgements in connection with their service as Directors.

Directors should be held liable to the shareholders and the Corporation for violations of their duty of loyalty involving gross or sustained and repeated negligence or illegality or other transgression.

#### **5. RIGHTS OF DIRECTORS**

A Corporation should provide Directors with an outline of their rights arising out of the Corporation's Constitution, the Corporations Act and other relevant instruments, before their appointment.

Directors should have access to training from independent sources to provide them with a clear understanding of their Directors' responsibilities and liabilities.

They should have reasonable access to the Corporation's employees, information and resources and be able to obtain independent professional or other advice at reasonable cost to the Corporation.

#### **6. BOARD ACCOUNTABILITY TO SHAREHOLDERS**

Corporate governance structures and practices should protect and enhance accountability of Boards to shareholders.

The Board should submit, for prior shareholder approval and action, any proposal that alters the fundamental relationship between shareholders and the Board.

Major corporate changes, which in substance or effect may impact shareholder equity or erode share ownership rights, should be submitted to a vote of shareholders. Sufficient time and information should be given to shareholders (including balanced assessment of relevant issues) to enable them to make informed judgements on these resolutions.

The Board should respond, where practicable, to communications from shareholders.

Any shareholder proposal approved by a majority of votes cast should either be adopted by the Board, or the next Annual Report should contain a detailed explanation of the Board's progress towards the introduction of the proposal.

#### **7. EVALUATION OF BOARD PERFORMANCE**

The Board should have mechanisms to evaluate and improve its performance governing the Corporation.



The Board should disclose its approach to regularly assessing the performance of individual Directors and the Board as a whole. Such an assessment should also involve an appraisal of the effectiveness of its Board, measured against criteria set by the Board.

The purpose of Board evaluation is to positively identify gaps in skills, experience and expertise that would need to be addressed in order to promote Board effectiveness and company performance over the long-term.

## **8. BOARD MEETINGS**

Board meetings should be conducted on a regular basis to ensure that the requisite amount of time is spent dealing with Board related matters.

Directors should be provided with appropriately detailed and accurate information in a timely manner prior to Board meetings.

The Board should be able to hold regularly scheduled meetings without the CEO or staff present.

The Independent Non-Executive Directors should also be able to hold meetings without Executive and Affiliated Non-Executive Directors, the CEO and staff being present.

Directors should ensure that they attend all Board meetings. A Director who attends fewer than 75% of Board and Board committee meetings for two consecutive years should not be renominated unless there are compelling and stated reasons for absenteeism.

## **9. DISCLOSURE OF BOARD INFORMATION**

Disclosure of information about the Directors and the Board is critical to enable shareholders to form a proper judgement about the effectiveness of the Board.

In addition to existing Corporations Act disclosure requirements, the disclosure of the following matters to shareholders significantly improves the transparency of the operation of the Board:

- > the cycle of Board and committee meetings;
- > the availability of the terms of reference for the Board and its committees;
- > Directors' attendance record at Board and committee meetings held during the year. Such disclosure should distinguish between in-person and telephonic attendance. Excused absences should not be categorised as attendance;
- > procedures and responsibilities in place to appraise the performance of the Board, committees and individual Directors;
- > procedures and responsibilities for succession planning;
- > full biographies for all Directors, including dates of appointment, ages, career history prior to and in the Corporation (in the case of Executive Directors), current and recent employment, other directorships and significant positions in public, commercial and political life and ongoing training;
- > any regulatory or statutory breaches of professional conduct;

- > Director's remuneration and its components so that shareholders can make proper assessments of the genuine value of a Director's package;
- > information necessary for shareholders to determine whether each Director qualifies as independent. To assist shareholders in making these determinations, Corporations should disclose all financial or business relationships with, and payments to, Directors and their families and all significant payments to Corporations, non-profit foundations and other organisations where the Corporation Directors serve as employees, officers, or Directors; and
- > the main terms of each Director's service contract or other contractual terms or letters of appointment.

## **10. LIMITATIONS ON TRADING IN CORPORATION'S SHARES**

A Corporation should disclose its policy with respect to trading in company securities by Directors, officers and employees.

ACSI supports an approach that restricts the times Directors may trade shares to specific 'trading windows'. ACSI considers that the London Stock Exchange Model Code provides a useful way forward on these matters and includes provisions worthy of consideration, including:

- > A Director not dealing in any securities of a listed company during a 'closed period' which is:
  - a period of two months immediately preceding the preliminary announcement of the Corporation's annual results;
  - period of two months prior to announcement of half yearly reports;
  - period of one month prior to announcement of quarterly results;
- > A Director may deal outside the closed period following receipt of clearance by the Chairperson. The Chairperson is required to receive clearance from the whole Board; and
- > A Director must not directly, or indirectly, apply to buy or sell shares of another Corporation about which they have price-sensitive information arising from his/her directorship of the Corporation.

## **11. CHAIRPERSON**

The Chairperson must ensure that the Board functions effectively and provides the leadership to oversee the operation of the Corporation. A Chairperson ensures that appropriate Board procedures and structures are in place, so that all relevant issues are considered by the Board.

A Chairperson is responsible for a number of key functions, including:

- > setting the agenda for Board meetings;
- > ensuring that a sufficient number of Board meetings occur during the year;
- > ensuring that the Board is provided with adequate information to facilitate effective decision-making;
- > leading the Board in monitoring the management of the Corporation, assessing the Corporation's financial position and performance, establishing a culture which encourages Directors to openly discuss risks or any material adverse developments.



The Chairperson also performs a critical role in managing the relationship between the Board, the CEO in a mentoring role, and key Corporation executives. The Chairperson has a role to work closely with the Company Secretary which is the first port of call for the Chairperson on legal and administrative items.

#### *11.1 Separation of Chairperson Role from CEO or Executive Director*

A Chairperson should be selected from the pool of Independent Non-Executive Directors on the Board. ACSI considers that combining the roles of Chairperson with CEO or Executive Director positions creates an unacceptable concentration of power and diminishes the degree of accountability that would usually result from a separation of the two roles. Therefore, the roles of Chairperson, CEO and Executive Director should be separated in listed Corporations.

In circumstances where the Chairperson is an Executive Director, the Independent Non-Executive Directors should nominate a “leader” of Non-Executive Directors who will assume leadership responsibilities associated with independent members of the Board.

#### *11.2 Multiple Chairperson Roles*

Because of the significant level of responsibility of Chairperson, it is not generally acceptable for the Chairperson of a listed Corporation to have the same high level responsibility in a similar position with another listed Corporation.

## **12. BOARD COMMITTEES**

ACSI believes that Board committees perform an important role in dealing with matters where Executive Directors could face a conflict of interest.

A Board should ensure that it establishes an Audit, Remuneration and a Nomination Committee. ACSI welcomes the establishment of Risk Management Committee by a number of Corporations to focus on the mitigation of various risks.

In general, a committee should be a reasonable size taking into account the size of the Board but should not be so large that it comprises a majority of the Board. For example, where a Corporation has a Board size of nine, then we would anticipate that a committee comprised of three members of the Board would be reasonable.

Where possible, the Chairperson of the Board should not be the Chair of the Audit Committee. This will, however, depend on the size of the Board. Where an Executive Chairperson oversees a Board, they should not also chair the Nominations Committee.

Boards should develop terms of reference outlining the scope and responsibilities of these committees. This also includes a policy regarding Board expectations about the number of meetings that should occur in the year and the obligations of each Director to attend. This information should be disclosed in Annual Reports.

The Audit Committee (including the chair of the committee) should be comprised solely of Independent Non-Executive Directors. Remuneration and Nomination Committees should comprise a majority of Independent Non-Executive Directors.

The members and chairs of the committees must be appointed by the Board.

Although it may be appropriate for these committees to invite executives and Executive Directors to be present at meetings, the committees should be able to meet without executives or Executive Directors present.

Committees should have the opportunity to select their own service providers and advisers at a reasonable cost to the Corporation.

The terms of reference for each committee should be available to shareholders on request.

### *12.1 Audit Committee*

The Audit Committee assists the Board to discharge its responsibilities in connection with the financial management, financial performance and financial reporting of the Corporation. This includes undertaking an appropriate corporate risk assessment, reviewing the system of internal controls, preparing the Corporation's financial statements and ensuring the independence of the Corporation's auditor and the quality of their audit.

An Audit Committee should be able to effectively review and assess the external reporting of the Corporation. Reporting to the Board on the performance of internal and external auditors and reviewing internal control mechanisms are fundamental functions of the Audit Committee.

Key features of an effective Audit Committee are outlined below:

- > written terms of reference are prepared setting out core matters to be dealt with by the Committee and the key rights and obligations of the Committee. This information should be made available to shareholders<sup>2</sup>;
- > the Audit Committee is comprised of Independent Non-Executive Directors with the required mix of skills, experience and relevant knowledge of the Corporation's operations;
- > there is a sufficient number of Directors on the Audit Committee who possess the necessary financial expertise to properly fulfil Audit Committee responsibilities;
- > the Audit Committee must have the appropriate powers to review the effectiveness of the external Auditor, to make recommendations to appoint, rotate or dismiss the auditors and to establish the scope of the audit;
- > the Audit Committee should set the ongoing competency requirements that the Auditor must meet;
- > the Audit Committee should be able to engage and dismiss internal auditors;
- > the Audit Committee should review the safeguards maintained by the external Auditor to ensure its independence and the competence of its audit engagement team;
- > the Audit Committee should be able to receive reports on all activities of internal and external auditors;

Footnote 2: ACSI has released a Model Charter for an Audit Committee prepared by Professor Robert Walker, University of Sydney



- > members of the Audit Committee should be able to liaise with Corporation executives, including Executive Directors, in order to facilitate effective implementation of the Committee's objectives;
- > the Audit Committee should receive a comprehensive report from the audit firm outlining the provision of non-audit work by the audit firm or any related entity and sign off on the quantum of non-audit services to be provided by the audit firm or a related entity;
- > the Audit Committee should also have access to external and independent resources in order to properly consider whether the provision of non-audit services is compatible with maintaining the Auditor's independence; and
- > the Audit Committee should be able to discuss matters with the external and internal auditors in the absence of management and Executive Directors.

### *12.2 Remuneration Committee*

The Remuneration Committee is responsible for developing, reviewing and approving the remuneration of Directors and senior executives.

The Remuneration Committee should have written terms of reference which include core responsibilities and a mechanism for the regular review of the Committee.

It will advise the Board as to whether remuneration, in the case of Non-Executive Directors, realistically reflects the responsibilities and risk involved in being an effective Director.

In the case of senior executive remuneration arrangements, it will ensure that the design and implementation of remuneration packages are linked to the Corporation's performance objectives.

The Committee should ensure that it promotes clear and understandable remuneration methodologies that support superior performance and the long-term growth of shareholder value. The Committee will assist the Board in the evaluation of the performance of the CEO against the various performance measures which underlie his/her remuneration package, including comparison with industry practice or other measures.

The Committee will be responsible for all aspects of executive remuneration, including design and implementation, contract provisions, retention and termination agreements. This includes being responsible for the appointment of remuneration consultants who report exclusively to the Committee and Board.

The Remuneration Committee is responsible for preparing the remuneration disclosure report which should be signed off by the Board and included in the Annual Report.

### *12.3 Nomination Committee*

The Nomination Committee should have written terms of reference which include core matters to be dealt with by the Committee and core rights of the Committee.

The Nomination Committee is responsible for:

- > proposing new nominees to the Board (after taking into account other external commitments and directorships held by candidates);
- > advising the Board on the procedures for assessing existing Directors' performance;
- > advising the Board about the Corporation's policies on the employment of Non-Executive Directors. This would include consideration of the appropriate mix of skills, experience and key competencies required to maximise the effectiveness of the Board; and
- > review of Board succession plans.

### **13. CHIEF EXECUTIVE OFFICER (CEO)**

The CEO is responsible for managing the organisation in accordance with the strategic objectives that have been endorsed by the Board.

The CEO is responsible for the achievement of the Corporation's strategy by harnessing appropriate human, financial, technical and administrative resources.

#### *13.1 Performance of the CEO*

The continuity of strong leadership is a primary and exclusive responsibility of the Board. There must be a clear understanding between the CEO and the Board regarding the expected performance requirements of the CEO and how that performance will be measured.

Boards should evaluate the performance of the CEO annually. The performance objectives should include both annual and multi-year performance periods.

### **14. REMUNERATION**

ACSI supports the inclusion of a remuneration report in the Corporation's Annual Report as an effective mechanism of disclosure for investors. The report should outline all key aspects regarding the determination of remuneration policy, in particular the linkage between the policy and performance in the interests of promoting long-term shareholder value. ACSI welcomes the direction of the CLERP 9 reforms that include giving shareholders a 'non-binding' vote on Corporation remuneration reports.

The Corporation should report the remuneration practices that are applicable to non-managerial employees, management employees and executives.

Because executives are responsible for influencing the direction of the Corporation, which ultimately affects shareholder return, executive remuneration should promote superior performance of a Corporation against comparable peer group(s) over the long-term.

Executives should not derive significant remuneration benefits in the absence of a direct contribution to long-term superior financial performance of the Corporation.



Remuneration should be regarded as a key tool to motivate executives and employees and harness their support of the long-term growth and success of the Corporation.

In broad terms, a properly structured remuneration scheme for executives should:

- > be reasonable in remunerating executives in a way which is aligned with shareholder interests;
- > be measurable against key corporate performance indicators;
- > be sufficiently market-oriented, within levels of comparability for similar peer group Corporations in the context of industry, size and business focus;
- > be properly and comprehensively described to shareholders including base cash remuneration, short-term bonuses and longer-term incentives or other rewards;
- > separately outline details relating to fixed remuneration bonuses and incentives and share scheme arrangements;
- > be fully disclosed, valued and expensed in accordance with regulatory requirements; and
- > be approved by shareholders.

#### *14.1 Termination Payments*

A Corporation should disclose its policy on notice periods and termination payments in Executive Service Agreements. This includes reference to compensation provisions that are applicable upon the termination of an executive's employment. The relevant 'triggers' for termination that arise should be disclosed.

A Corporation should ensure that an Executive Service Agreement provides a reasonable basis to procure the early termination of an executive, in circumstances where poor and inadequate performance by the executive against previously agreed benchmarks has occurred.

Corporations should therefore be discouraged from paying out excessive and unreasonable termination payments in circumstances where the termination is as a consequence of poor and inadequate performance.

Properly constructed "liquidated damages" clauses are one way of restricting payouts to executives who depart following a period of poor performance. These clauses typically allow for termination payments even where the executive's performance has been below a required standard (though not so bad as to constitute dismissal for "cause"), but the size of the payout is delimited in advance. ACSI supports liquidated damages clauses in Executive Service Agreements that:

- > provide a maximum liquidated damages payout of no more than 12 months' base salary;
- > provide that no amount (other than statutory entitlements such as accrued leave) is payable where the executive is dismissed for cause, ie misconduct, wilful neglect or serious breach of the Executive Service Agreement.

In circumstances where an executive is dismissed for underperformance (not amounting to cause), the Executive Service Agreement should provide that all unvested performance and incentive-related elements of the executive's remuneration package are forfeited. There should be a clearly defined, and not excessive, time-frame during which vested options and other incentive instruments may be exercised, provided that performance hurdles have been satisfied prior to termination.

In circumstances where an executive is dismissed for cause, the Executive Service Agreement should provide that all performance and incentive-related elements of the executive's remuneration package are forfeited. This includes options and other incentive instruments that are unvested at the time of dismissal, and also options and other incentive instruments that have vested but have not been exercised at the time of dismissal.

ACSI supports the introduction of UK-style proposals that provide for the outstanding term of a contract to be paid in 'phased' termination payments that cease when an executive finds other employment.

ACSI supports legislative reform that would provide shareholders with a greater say in termination benefit payments. Existing caps currently applicable under sections 200F and 200G of the Corporations Act, that allow for shareholders' approval of termination payments that exceed seven-times annual remuneration are considered to be too generous. ACSI considers that termination benefits worth more than a 12 months' base salary should require approval by shareholders.

ACSI supports bringing Australian disclosure provisions relating to Executive Service Agreements in line with US provisions, that compel listed companies to file a copy of Executive Service Agreements with the Securities and Exchange Commission (SEC) at the time a senior executive is hired. This ensures that the contractual provisions dealing with a potential termination payout are made public contemporaneously with the hiring of the executive. This will overcome the latitude that is currently available to Australian Corporations to disclose key details of Executive Service Agreements, such as termination provisions, as late as 15 months after the executive is hired - when the next Annual Report is published.

#### *14.2 Disclosure, Valuation and Expensing of Remuneration*

It is of critical importance that all elements of remuneration, including all fixed and variable components, are properly disclosed, valued and expensed. A Corporation should ensure that it meets the various disclosure requirements arising out of the Corporations Act. This also includes the requirement to appropriately value remuneration arrangements under the Corporations Act.

#### *14.3 Fixed Remuneration*

Fixed remuneration is a component of the total compensation of all employees in the Corporation. It should take into account legal, industrial and other obligations of the Corporation.

In relation to executive remuneration, the fixed component of a remuneration package should be relative to the scale of business as measured by sales, assets, number of employees and total market capitalisation.

General increases in fixed remuneration for executives should have regard to the rate of increases applicable to the rest of the Corporation's workforce.

#### *14.4 Variable Remuneration*

Variable remuneration includes short-term incentives (such as an annual bonus) and long-term incentives (such as share options or share-based incentives).



All variable remuneration schemes should be provided in reasonable amounts and be underpinned by clear and relevant performance hurdles.

With respect to annual bonuses that are usually paid in cash, these payments should be linked to clear key performance requirements and targets. Such requirements should generally be disclosed in the Corporation's Remuneration Report subject to "commercial in confidence" requirements. Where commercial confidentiality applies, shareholders should be informed of the parameters adopted in the financial year for the bonus arrangements.

With respect to other forms of variable remuneration that provide levels of long-term reward, Corporations should explain how high levels of potential reward are tied to stretching and demanding performance conditions, particularly where a Corporation makes an annual grant of options (or other long-term incentive awards) the value of which exceeds one times base salary.

In particular, share-based incentive plans should generally be valued at a level that is a reasonable and explainable multiple of the executive's fixed remuneration.

#### *14.5 Performance Conditions for Long-Term Incentive Schemes*

The performance conditions for long-term incentive schemes (eg share option plans and share-based incentive plans) should be designed to reward executives for contributing to long-term, above average corporate performance.

ACSI encourages the utilisation of dual performance hurdles to be satisfied before any share options or other long-term incentive instruments vest, which measure the Corporation's performance on an absolute and relative basis.

An example of an "absolute" measure of performance includes a Corporation's earnings per share exceeding a target established by the Board. In this regard, a target should be sufficiently demanding. An example of a "relative" performance measure is where the Corporation's Total Shareholder Return must place the Corporation at a certain point in a ranking against an identified set of peers.

ACSI will, however, accept the utilisation of one performance hurdle, provided it is a relative performance measure that is sufficiently challenging and requires the achievement of out-performance against relevant and disclosed external benchmarks.

In general, ACSI will not support remuneration schemes, or proposed grants of incentives under them, where performance hurdles are not sufficiently demanding. What will be regarded as sufficiently demanding is a case-by-case judgement; however, the following guidance is of general application:

- > where a relative hurdle is used, there should be no vesting unless the company's performance is ahead of at least half of peer Corporations;
- > ACSI is generally supportive of hurdles which allow for 'variable reward' - under which the number of options (or other long-term incentive instruments) that vest increases on a sliding scale according to the level of corporate performance achieved. This is preferable to a hurdle that allows for all options (or other long-term incentive instruments) to vest for median, or slightly better than median, performance;

- > where a share incentive scheme provides for 'performance rights', 'performance shares', 'deferred shares' and other zero exercise price options ("zeps") with an exercise price of zero, it is particularly important that challenging performance hurdles are in place. This is because these instruments lack the inherent share-price appreciation hurdle that traditional options possess;
- > performance hurdles need to be explained clearly - both in the Annual Report and also in the Notice of Meeting - when a grant of options (or other long-term incentive instrument) is put to shareholders for approval. Information about the hurdle needs to be sufficient in detail and clarity, to enable investors to determine whether it will allow for executives to be rewarded only if long-term corporate performance is enhanced;
- > re-testing of performance hurdles is a matter of growing importance. ACSI is generally opposed to re-testing, but is prepared to assess each case on its merits, as detailed in Section 14.7; and
- > performance hurdles are equally important for loan-funded share plans, as detailed in Section 14.10.

#### *14.6 Other Aspects of Long-Term Incentive Schemes*

##### *Types of schemes*

Corporations may provide share option schemes for their executives or promote share incentive and reward schemes as an appropriate method of long-term variable remuneration.

Although share incentive and reward schemes may not result in the same dilutive impact on existing shares as a share option arrangement, a share incentive scheme may in itself be unacceptable if it has insufficiently demanding performance hurdles.

Share option schemes providing options in reasonable amounts and with challenging performance hurdles can still be regarded as a reasonable incentive for executives. The key considerations for option schemes are that they should have reasonable conditions of issue, be issued in reasonable quantities, and that there is proper disclosure, valuation and expensing of these arrangements.

##### *Frequency of grants*

The Board should ensure that grants of options (or other long-term incentive awards) are made regularly (eg annually) in preference to one large tranche every three or four years. This is designed to:

- > reduce the risk of unanticipated outcomes that arise out of share price volatility and cyclical factors;
- > reduce the possibility that a limit on subsisting options encourages early exercise;
- > allow the adoption of a single performance measurement period;
- > reduce the possibility of 'underwater' options, where the share price falls below the exercise price<sup>3</sup>;

##### *Exercise price*

The exercise price for options should not be less than the average of the share price on the five days of trading before the options are granted.

Footnote 3: The points raised above have been adapted from Association of British Insurers 'Principles and Guidelines on Remuneration', published 7 December 2004



Scheme rules should not be altered to make it easier for the executive to exercise options, where there has been a fall in share price or performance (ie repricing of options and adjustment of targets).

Option scheme rules should not give the Board or a Board Committee, or the plan administrator, discretion to lower the exercise price of options that have already been awarded, where the market price of the shares has fallen below the original exercise price.

A company may bring about substantially the same result as repricing by granting a new tranche of options to its executives if last year's grant is now underwater. Some Australian companies have replaced underwater options in this way in recent years. ACSI does not support this practice.

#### *Vesting period*

Grants of options and other long-term incentive instruments should incorporate a minimum acceptable vesting period of at least three years.

Where a scheme utilises phased vesting schedules, that is, where options or rights vest in tranches (eg one-third of options vest after three years; one-third vest after four years; and one-third vest after five years), then each vesting of awards should be linked to sustained performance requirements.

#### *Holding lock*

A holding lock is a requirement that shares received on exercise of options, or after performance rights vest, must be retained for a further defined period of time. ACSI supports a holding lock period of between one to three years.

#### *Disclosure*

The following information should be disclosed:

- > the expiry date for options or other long-term incentive instruments should be disclosed in both the Annual Report and also the Notice of Meeting when a grant of options (or other long-term incentive instruments) is put to shareholders for approval;
- > the Annual Report should disclose the number of shares available/eligible for issue and actually issued under the option scheme or share-based incentive scheme;
- > the Annual Report should disclose the value and number of share options and shares granted, exercised and outstanding under all incentive plans, in accordance with the Corporations Act;
- > where shareholder approval is being sought for a particular grant of options or other long-term incentive instruments, the Notice of Meeting should disclose the value of those options/instruments;
- > the Annual Report and the Notice of Meeting (where relevant) should disclose the valuation method used to value options. In particular, any discount factor applied as part of the valuation (eg to take account of the possibility of performance hurdles not being satisfied in whole or in part, or to take account of an executive leaving the company and surrendering options) should be disclosed clearly (including its quantum); and
- > the Annual Report should disclose the exercise price of share options (or the method of determining it).

### *Valuation and expensing*

In relation to the requirement to value share options and other long-term incentive instruments, Corporations should utilise an internationally recognised method of valuation, such as the Black-Scholes methodology, in order to meet the requirements of the Corporations Act and Accounting Standards.

Grants made under share incentive and option schemes should be properly expensed in Corporations' financial statements in accordance with the appropriate accounting standards. Boards should ensure that they are sufficiently apprised of the requirements of these standards and apply them accordingly in the relevant disclosure provisions in Annual Reports.

### *Dilution*

The dilutive impact of share option and share incentive plans on existing shareholders should not be excessive. This will generally depend on the value of options and shares issued and the position of the Corporation, particularly whether it is a new and emerging Corporation or one that is established and mature.

In general, prior shareholder approval should be required where any single share or share option scheme could result in shares equal to 5% or greater of total issued ordinary shares being allocated. Generally the total number of shares and options for executives and employees, under all schemes, should not exceed 10%. ACSI will consider, on a case by case basis, share and share option schemes that provide for a total potential dilution (under all the company's schemes) of up to 10%.

ACSI will not support share or share option plans, or grants under those plans, where the 'flow rate' (ie the total number of options and shares granted in any one year, expressed as a percentage of total issued ordinary shares) exceeds 2%. ACSI will consider, on a case by case basis, plans, and grants under plans, where the flow rate exceeds 1% but is less than 2%. A flow rate of less than 1% is generally acceptable.

### *14.7 Re-testing of Performance Hurdles*

Where performance conditions or hurdles have not been met at the vesting date, the ability to 're-test' the hurdle on a future date or dates is now an unacceptable aspect of corporate governance in some countries. ACSI is generally opposed to re-testing, but is prepared to assess each proposal on a case by case basis.

### *14.8 Options and Performance Rights Following Retirement or Resignation*

Options (or other long-term incentive instruments) should be exercised within one year after retirement or otherwise they lapse. Performance conditions should not be waived.

ACSI will consider proposals that allow for a pro rata number of options/performance rights to be exercisable where the executive resigns from the Corporation during the vesting period.

Section 14.1 details ACSI's policy in relation to the treatment of long-term incentives where an executive is dismissed for cause or for poor performance.



#### *14.9 Change of Corporate Control*

ACSI does not support the full vesting of options and performance rights in the event of a take over or change of control in the Corporation, irrespective of how far into the vesting period the options are and whether or not performance hurdles have been satisfied.

ACSI is however prepared to consider the pro rata vesting of options/performance rights, to take into account any period of vesting that has accrued up until the time of change of control.

#### *14.10 Loan-Funded Share Plans*

ACSI does not support loans to be made to executives on a non-commercial basis, so that they may take up shares.

With respect to non-recourse or limited recourse loans, ACSI supports share plans that provide that where shares are forfeited by an executive, the Corporation is able to sell the shares on-market to recoup some or all of what was owed by the executive.

ACSI views loan-funded share plans as analogous to option plans, and therefore expects challenging performance hurdles to also apply to loan-funded share plans.

#### *14.11 Option Hedging*

ACSI does not support Corporations allowing their executives to obtain financial products to remove the risk associated with share options in their remuneration package. This practice negates the rationale for variable remuneration schemes that should apply when an executive has contributed to above average corporate performance.

#### *14.12 Director Remuneration and Share Ownership*

All forms of remuneration paid to Directors should be disclosed in accordance with Corporations Act and ASX Listing Rule requirements.

Independent Non-Executive Directors should be encouraged to acquire shares from an allocation of fees paid for undertaking their directorship.

ACSI does not support the creation of a retirement benefit plan for Independent Non-Executive Directors (excluding Superannuation Guarantee payments).

All monetary arrangements with Directors for services outside normal Board activities should be approved by the Remuneration Committee of the Board.

## 15. SHAREHOLDER RIGHTS AND PROXY VOTING

Access to the proxy voting process is an important means by which shareholders can ensure that Directors are held accountable for their actions and the future direction of the Corporation.

Proxy voting is therefore a key mechanism by which shareholders play a role in the governance of the Corporation. General principles of shareholder rights require Corporations to encourage shareholder access to the proxy process.

### *15.1 Voting Rights and Procedures*

ACSI supports initiatives adopted by Corporations to overcome some of the impediments and constraints to more active shareholder involvement. The Corporations Act, the Constitution of Corporation and the ASX Listing Rules also outline in detail the rights of shareholders in relation to calling a general meeting, resolutions, proxies and voting requirements. These provisions should provide balanced requirements on a Corporation without setting impossible benchmarks for shareholders to utilise, particularly in relation to calling general meetings or proposing resolutions.

ACSI supports legal mechanisms to improve participation, particularly through electronic communications and voting processes.

Outlined below are general supplementary principles related to other initiatives which ACSI supports:

- > electronic voting over paper-based voting;
- > confidential voting processes;
- > voting by poll so that resolutions are passed according to level of share ownership and not merely relying on a show of hands at a general meeting;
- > provision of adequate information in the form of explanatory notes to enable more informed decisions by shareholders;
- > all information supplied to shareholders must be unbiased - additional information should be made available upon request;
- > shareholders should be provided with adequate information on all Directors and resolutions;
- > shareholders, including beneficial owners of shares, should be able to receive documents directly from the Corporation;
- > ACSI encourages Corporations to disclose on their web-site information about beneficial holding details obtained within two days of receiving the information. This complements the requirement for Corporations to make the information publicly accessible through an entry in their register;
- > voting by shareholders should be democratic and transparent and all ordinary shares should have equal rights;
- > shareholders should have reasonable access to minutes of general meetings;
- > shareholders should be allowed to vote separately on unrelated issues. Therefore, resolutions should not be bundled;
- > shareholders should be given the right to vote on executive and Director remuneration policy; and



- > Chairpersons should vote proxy votes in accordance with the way they are directed. Corporations should provide appropriate disclosure in relation to how undirected proxies have been voted by the Chairperson.

#### *15.2 Shareholder Meeting Rights*

Appropriate notice of shareholder meetings, including notice concerning any change in meeting date, time, place or shareholder action, should be given to shareholders in a manner and within time frames that will ensure that shareholders have a reasonable opportunity to exercise their vote. ACSI supports the retention of a 28 day notice of general meeting for listed Corporations.

All Directors should attend annual shareholders' meetings and be available, when requested by the Chairperson, to answer shareholder questions.

Polls should remain open at shareholder meetings until all agenda items have been discussed and shareholders have had the opportunity to ask and receive answers to questions concerning them.

Corporations should not adjourn a meeting for the purpose of soliciting more votes. Adjourning a meeting should only be done for compelling reasons such as vote fraud, problems with the voting process or lack of a quorum.

Corporations are encouraged to hold shareholder meetings by remote communication (ie electronic meetings) only as a supplement to traditional in-person shareholder meetings and not as a substitute. Corporations should utilise appropriate forms of technology to facilitate electronic voting.

#### *15.3 ASX Corporate Governance Council Principles*

Corporations should ensure that they prepare clear and informative responses to the ASX Corporate Governance Council Principles, and that they provide shareholders with an understanding of the Corporation's approach to the Principles.

#### *15.4 Existence of Controlling Shareholders*

Where Corporations have controlling shareholders, they should comply with the normal best practice guidelines and there should be safeguards for minority and non-controlling shareholders built into Board structures and Constitution as follows:

- > there should be disclosure in the report and accounts of all connections and relationships past and present between Directors and controlling shareholders;
- > the existence of any relationship agreements should be disclosed; and
- > the Chairperson should not have any connection to the controlling shareholder.

Where the controlling shareholder owns or controls, singly or jointly, more than 50% of the voting rights, the controlling shareholder should abstain from voting on the election of any Director related to the controlling shareholder.

## **16. CONTINUOUS DISCLOSURE**

Corporations should ensure that they have the appropriate processes and structures in place to effectively meet existing continuous disclosure requirements.

All information provided to shareholders should be true and fair, even where contentious issues are at stake.

Corporations should ensure that they release sufficient information to enable all investors to make informed and accurate judgements about issues that could impact on the value of their shareholdings.

The timely release of, and equal access to, information is important to ensure that all investors are properly informed.

The Board of Directors should prominently and clearly disclose, in a separate section of its Annual Report, its approach to Corporate Governance. This should include an analysis of the Corporate Governance issues specific to the Corporation so that shareholders understand how the Corporation deals with those issues.

## **17. CORPORATE FINANCIAL INTEGRITY**

It is of critical importance that the system of financial reporting of a Corporation provides an accurate and true representation of its financial position.

The Board and Auditors should undertake sufficiently detailed analysis and enquiry into the Corporation's accounts to ensure that all Australian accounting standards have been met.

A Corporation's CEO and the Chief Financial Officer should certify to the Board that all relevant financial information has been presented to the Board and that this provides a true and fair view of the Corporation's financial position and affairs.

## **18. RISK MANAGEMENT**

The Board of a Corporation has a critical role in reviewing and ratifying strategies to manage a broad spectrum of risks that impact on the Corporation. ACSI regards risk oversight as a critical responsibility of the Board (and where relevant, a Risk Management Committee should be established).

ACSI supports the guidance notes arising out of ASX Corporate Governance Council Principle 7, "Recognise and Manage Risk", that requires Boards to:

- > oversee the establishment and implementation of the risk management system;
- > review the effectiveness of the risk management system.



As part of a Corporation's approach to risk management, Corporations are encouraged to develop and disclose their whistleblower policies.

ACSI will seek from Corporations information regarding risk oversight and the management of internal controls to deal with risk issues, in the context of the achievement of the Corporation's objectives.

## **19. RELATIONSHIP WITH THE AUDITOR**

Shareholders are entitled to have high levels of confidence in the financial statements of a Corporation. These statements should provide an accurate and detailed account of the Corporation's financial position.

In this regard, external auditors play a key role in verifying the accuracy of financial statements for the benefit of all shareholders. An important obligation of auditors is to certify that the Corporation accounts represent a true and fair view of the affairs of the Corporation. It is fundamental that auditors discharge their duties and responsibilities without being influenced by factors that could impede, or be perceived to impede, their independence. Accordingly, auditors should attend Annual General Meetings to answer questions from shareholders in relation to the accounts and external audit.

### *19.1 Auditor Independence*

Auditors are required to be, and be seen to be, independent and free of any interest which might be regarded as being incompatible with integrity and objectivity. For an auditor to be independent, there should be no significant financial, business or employment relationship between the audit client and the signing audit partner and the audit firm.

The existence of such relationships may create self-interest, familiarity or the threat of intimidation, all of which compromise the integrity of the audit.

Financial relationships arise where the Auditor:

- > directly invests in audit clients;
- > has a material indirect financial investment in the client;
- > is involved in loans to and from audit clients.

Business relationships arise where the audit firm or a member of the audit engagement team has a business relationship with the audit client or an officer of the client, which is not insignificant to the audit team member/firm of the client.

Employment relationships arise where the Corporation employs:

- > a current or former partner of an audit firm or an employee of an auditor;
- > an immediate family member of a member of the audit engagement team who is in a position to affect the subject matter of the audit engagement.

### *19.2 Provision of Non-Auditing Services*

ACSI considers that an audit firm can provide a limited range of non-auditing services, provided that the fees paid for non-audit work and the level and nature of non-auditing work performed is disclosed in the Financial Reports of the Corporation. An audit firm should submit a comprehensive report to the Audit Committee outlining the provision of non-audit work by the firm or any related entity.

The Audit Committee should verify that it has considered and signed off on the quantum of non-audit services to be provided by the audit firm or a related entity. If it cannot so verify, then the Auditor should be changed.

ACSI believes that the following services should not be provided by the same audit firm performing the audit for the Corporation, as they may be perceived to be materially in conflict with the role of the auditor:

- > preparing accounting records and financial statements;
- > valuation services;
- > internal audit services;
- > IT system services;
- > broker or dealer services;
- > investment advice;
- > investment banking services;
- > legal services;
- > taxation advice.

### *19.3 Auditor Familiarity*

Signing audit partners should be rotated every five to seven years. The Audit Committee should be involved in an ongoing review of the firm and its services, with active consideration given to rotating the audit firm every ten to twelve years. Where the audit firm is rotated, the personnel who assume responsibility for conducting the audit should not be the same personnel (for example, situations could arise where an audit partner moves firms and could continue to be responsible for auditing the Corporation).

### *19.4 Auditor Competency*

The Auditor must meet appropriate ongoing competency requirements that are set down by the Audit Committee.

### *19.5 Auditor to Provide Statements of Independence*

The Auditor should provide an annual statement that no circumstance has existed during the year that has affected the independence of the audit engagement team or audit firm. Where a perceived lack of independence exists, the Auditor should outline the arrangements in place to ensure that the quality of the audit was not compromised.

This statement should be included in the Financial Reports of the Corporation.



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