

**Contents**

2007 DIARY NOTES	1
AWB – AN INCONVENIENT CULTURE	1
ASX CORPORATE GOVERNANCE COUNCIL GUIDELINE REVIEW	4
TREASURY CONSULTATION	5
WHY COMPANIES DELIST	5
UN PRI IN PRACTICE	6
ACSI SIGNS UP TO UN PRI	7
AUSSIE CARBON DISCLOSURE PROJECT	7
FROM THE MOUTHS OF BABES – A TEENAGER'S VIEW OF CLIMATE CHANGE	9
OVERSEAS DEVELOPMENTS	10

This lengthy report looks at the actions of the Board and the executives of AWB, implications for BHP's Tigris and the knowledge of government officials and departments. In this article we focus on the implications for the AWB Board and the executives from a governance perspective.

Outlined below is the prologue to the report prepared by Commissioner The Right Honourable Terence RH Cole AO RFD QC, which gives a succinct overview of the findings from the inquiry.

"I have examined in detail the transactions between AWB Limited and Iraq and the relationship of those transactions to United Nations sanctions and the law in Australia. The facts are now not in doubt. It is not my function to make findings of breach of the law; my function is to indicate circumstances where it might be appropriate for authorities to consider whether criminal or civil proceedings should be commenced. I found such circumstances to exist. If proceedings are commenced, and are successful, the consequences for individuals might be great. However, for AWB, any monetary consequence of any proceedings prosecuting authorities might bring would be less significant.

The consequences of AWB's actions, however, have been immense. AWB has lost its reputation. The Federal Court has found that a 'transaction was deliberately and dishonestly structured by AWB so as to misrepresent the true nature and purpose of the trucking fees and to work a trickery on the United Nations'. Shareholders have lost half the value of their investment. Trade with Iraq worth more than A\$500 million per annum has been forfeited. Many senior executives have resigned, their positions being untenable. Some entities will not deal with the company. Some wheat farmers do so unwillingly but are, at present, compelled by law to do so. AWB is threatened by law suits both in Australia and overseas. There are potential further restrictions on AWB's trade overseas. And AWB has cast a shadow over

**2007 DIARY DATES**

- 16 April 2007**  
Seminar - Sydney 12.00-2.00pm
- 15 June 2007**  
ACSI Conference - Melbourne
- 19 November 2007**  
ACSI AGM - Melbourne from 5.00pm

Seminars will also be held in Melbourne and Brisbane during 2007. Dates and venues will be advised in due course.

**AWB – AN INCONVENIENT CULTURE**

On 24 November 2006 the Inquiry into certain Australian companies in relation to the UN Oil-For-Food Programme "The Cole Inquiry" presented the Report of his Inquiry to the Governor-General.

Australia's reputation in international trade. That shadow has been removed by Australia's intolerance of inappropriate conduct in trade, demonstrated by shining the bright light of this independent public inquiry on AWB's conduct.

How could AWB have conducted itself in such a way as to produce such consequences? I asked Mr Lindberg, without any objection from AWB or its directors, 'Are you able to give me any understanding as to how you think this came about? How it happened in a company like AWB?' Mr Lindberg gave no answer other than to say that it should not have happened. AWB submitted that the question I asked was, obviously a question the directors must consider and answer.

I consider the answer obvious.

The conduct of AWB and its officers was due to a failure in corporate culture. The question posed within AWB was:

What must be done to maintain sales to Iraq? The answer given was:

Do whatever is necessary to retain the trade. Pay the money required by Iraq. It will cost AWB nothing because the extra costs will be added into the wheat price and recovered from the UN escrow account. But hide the making of those payments for they are in breach of sanctions.

No one asked, 'What is the right thing to do?' Instead, much time and money was spent trying to determine if arrangements could be formulated in such a way as to avoid breaching the law or sanctions, whether conduct could be protected, by various subterfuges, from discovery or scrutiny, and whether actions were legal or illegal.

There was a lack of openness and frankness in AWB's dealing with the Australian Government and the United Nations. At no time did AWB tell the Australian Government or the United Nations of its true arrangements

with Iraq. And when inquiries were mounted into its activities it took all available measures to restrict and minimise disclosure of what had occurred. Necessarily, one asks, 'Why?'

**The answer is a closed culture of superiority and impregnability, of dominance and self-importance. Legislation cannot destroy such a culture or create a satisfactory one. That is the task of boards and the management of companies. The starting point is an ethical base. At AWB the Board and management failed to create, instil or maintain a culture of ethical dealing.**

A government grant, by legislation, of a monopoly power confers on the recipient a great privilege. It carries with it a commensurate obligation. That obligation is to conduct itself in accordance with high ethical stands. The reason such an obligation is imposed is because, by law, persons are denied choice with whom they may deal.

It is not my function to comment on the grant of monopoly power to part of the AWB group, and I do not do so. Nor is it my function to classify or judge the conduct of AWB against some indeterminate standard, and I do not do so. In my report I describe the conduct of AWB in its dealings with Iraq. It is for others to determine whether, as a matter of public policy, it is appropriate for the law to require persons to deal with a group that behaved in the manner I describe."

In addition to the enormous damage to the reputation of the company the outcome from the enquiry will see ten current and former employees investigated for possible criminal actions including misleading a Commonwealth Government Official, marking false representations and fraud – all of which attract a maximum penalty of two years' prison.<sup>1</sup>

<sup>1</sup> The Age 'Lindberg in clear, but others under the gun',

## Governance Deficiencies

AWB's corporate structure consists of A class and B class shares. A class shares can only be owned by current wheat growers and specifically exclude dividends. However, they provide A class shareholders with a number of rights, including the ability to elect the majority of the Board of Directors.

In contrast, B class shares are quoted on the Australian Stock Exchange and can be owned by either wheat growers or non-wheat growers. B class shares carry rights to receive dividends and the right to elect a minority of the Board.

Due to the fact that a majority of AWB Limited's directors are elected by A class shareholders, most of those directors are wheat growers, who have commercial dealings with AWB and therefore in terms of ACSI's guidelines would be classified as affiliated. If you consider the structure of the Board as at the February 2006 AGM prior to the resignation of Mr Lindberg, the Board comprised of 3 independents, 1 executives and 8 affiliated directors.

Dimity Kingsford Smith, Professor, Faculty of Law, UNSW in the AFR on Thursday 20 November 2006 "On the face of it, all was compliant, AWB had an overwhelming non-executive board, it had audit, remuneration and risk committees. By 2003, when the ASX corporate governance guidelines tightened up, it had adopted a charter of corporate ethics and a code of corporate conduct. Like HIH, it had ticked all the ASX corporate governance boxes."

While ACSI disagrees that all the boxes were in fact 'ticked' given the overwhelming representation of affiliated directors we support the concern she also raised with regard to the questioning the auditors' role, in failing to query the inconsistent terms of export contracts. She also raised questions over the ability of directors who had lengthy tenures on the board to bring independent judgement to bear. In particular Trevor

Flugge was a director of the Australian Wheat Board since 1987, to which he eventually became the chairman before joining AWB Ltd. As Ms Kingsford Smith noted from the 1999-2000 annual report (when the payments started) four of Mr Flugge's directors were in a similar position.

In a conclusion that would be widely embraced she states that, **"Corporate culture is not produced out of thin air. It is a product of structures, attitudes and actions. It is the result of human agency and, strikingly in this case, the result of failures to act, specifically, it results from failure of information flows, failure to ensure truly independent scrutiny and tolerance of unethical behaviour."**

## AWB's response

While the Inquiry did not make any adverse findings against the current directors following the release of the report Brendan Stewart, Chairman of AWB advised that the Board is committed to a renewal of the Board including the role of the chairman.

In terms of governance, AWB has appointed KPMG in February 2006 to review the current governance, internal reporting structures and practises of the Company generally, and its practical application. ACSI will closely monitor the developments with respect to the ownership and governance structure going forward.

AWB appointed a new Managing Director, Gordon Davis, on 11 September 2006 and a new executive team has been established.

AWB has embarked on a cultural change program engaging over 600 staff to develop and commit to a set of values that will guide employees in interactions with stakeholders and with each other.

Notwithstanding the current boards willingness to address obvious governance deficiencies, the company must in future address and improve the composition of the

board to ensure more effective, independent oversight over management, including better information flows and improve the ability for the participation of shareholders.

The key question is whether all these changes going forward will be too late, given the Federal Governments position on the single desk policy.

As with Enron and HIH, from a corporate governance perspective a company may be perceived to have ticked some of the right boxes, however, the Board needs to set the tone from the top, they need to apply independent judgement and they and executives when faced with difficult business decisions need to ask 'What is the right thing to do?'. There is no point in having governance processes if they are not applied.

**ASX CORPORATE GOVERNANCE COUNCIL GUIDELINE REVIEW**

On 2 November 2006 the ASX Corporate Governance Council (ASX CGC) released consultation documents putting forward proposals for the revision of the 2003 Principles of Good Corporate Governance and Best Practice Recommendations.

ACSI is holding a forum for its members at 11.00am – 4.00pm on Thursday 7 December 2006 in the Cbus Boardroom, level 28, 2 Lonsdale Street, Melbourne, 3000 to go through the revisions and to seek ACSI's members' views on the proposed changes so that we may make an informed submission by 9 February 2007.

The key changes to the guidelines cover the following areas:

- The guidelines now make reference to 'good practice' instead of 'best practice' and the number of principles has been reduced from 10 to 8.

- Removal of regulatory overlap between the guidelines, the Corporations Act and the Accounting Standards.
- Removal of areas of overlap in relation to sign off on financial statements.
- Following ACSI's research paper 'Disclosure Implications of Executive Hedging Long Term Incentives' the ASX CGC has recommend that
  - the hedging of unvested options be prohibited and
  - propose that reporting should occur at least internally in relation to any hedging of vested incentives so that the company can ensure that companies do not inadvertently hold out that entitlements are 'at risk'.

A separate consultation paper (Part B of the Explanatory Paper) has been prepared in relation to the issue of corporate responsibility/sustainability.

It is anticipated that ACSI's submission will focus predominantly on the following areas –

- The proposal to restructure the existing principles into one document containing a set of high level principles and an accompanying document describing issues to consider when applying the high level principle.
- Supplementary Guidance to be provided in relation to Principle 7 in Part B 'Reporting of material Business Risks and Corporate Responsibility/Sustainability Risks'.
- Following representations by ACSI the ASX is consulting through this process on suggested positions in relation to ASX Listing Rule 10.14 and Corps Act requirements in relation to shareholder approval of equity-based executive remuneration plans.
- The proposed amendments in relation to the hedging of long-term incentives.

The Review of the Principles of Good Corporate Governance and Best Practice Recommendations are available at –

[http://www.asx.com.au/supervision/governance/principles\\_good\\_corporate\\_governance.htm](http://www.asx.com.au/supervision/governance/principles_good_corporate_governance.htm)

We hope to canvass many of your views at our forum on Thursday 7 December 2006.

### **TREASURY CONSULTATION**

Treasury have introduced a package of proposals for 'simplifying the regulatory system and reducing unnecessary or excessive red tape'.

Whilst the majority of the proposals relate to financial service regulation changes, there are a series of proposals that impact on company reporting obligations, auditor independence and corporate governance.

ACSI welcomes the majority of the changes and will engage with Treasury on various governance provisions. Whilst Treasury has responded to ACSI's much publicised views on hedging, we regard the proposals as a first step. Some of the note worthy proposition include:

#### **Executive Remuneration**

- All companies that are disclosing entities would be required to prepare an audited remuneration report.
- Remuneration disclosure to all 'Key Management Personnel' and extend to the five most highly remunerated executives.
- Require Board policy disclosure on executive remuneration hedging.

#### **Corporate Governance**

- Remove requirement for member approval of small payment to related parties by introducing a prescribed threshold amount of \$5,000.

ACSI will be submitting a response to the Treasury paper in due course. The consultation closes on 22 December 2006 and the consultation document can be found at:

<http://www.treasury.gov.au/contentitem.asp?NavId=&ContentID=1189>

### **WHY COMPANIES DELIST**

The Centre for Corporate Law & Securities Regulation at the University of Melbourne has released an interesting paper 'Corporate Law Reform and Delisting in Australia'.

The researchers examined 5,952 delistings from the ASX for the 30 year period 1975 to 2004.

They found that the main reasons for delisting were: name changes (40% of delistings), being acquired (19%), capitalisation changes (19%), and failure to pay listing fees (8% - generally due to the company being in financial difficulty). There was no evidence that companies delisted because of corporate law reforms or excessive reporting requirements. There was a small number of delistings (23) where the company delisting stated that the cost of being listed exceeded the benefits.<sup>2</sup>

Delisting has been increasing each decade for the last three decades. On average, 150% of the ASX board delists each decade.

The paper also found that the length of time companies are listed on the ASX before delisting was a mean of eight years and the median of four years. In total 78% of companies that delisted did so within nine years of listing.

For a copy of this paper <http://ccslr.law.unimelb.edu.au/go/news/index.cfm>

<sup>2</sup> CCH, 'Delisting: corporate law reforms not to blame' 29 November 2006

## UN PRI IN PRACTICE

James Gifford, Lead Project Manager, UN Principles for Responsible Investment (UNPRI) provided an insightful presentation at ACSI's AGM on Monday 13 November 2006. Outlined below are the key messages from his presentation.

The objective of the Principles for Responsible Investment (PRI) was to develop and implement a set of global principles that facilitate the integration of Environmental Social and Governance (ESG) issues into mainstream investment practices.

The design of the principles took one year and was convened by the UN Secretary-General and implemented by UNEP FI and UN Global Compact and was led by mainstream institutional asset owners and backed by a multi-stakeholder expert group. The Principles themselves:

- reflect a broad and long term understanding of materiality;
- are grounded within the bounds of fiduciary duty;
- can be applied across mainstream portfolios, and
- provide practical guidance on key challenges.

Currently there are 55 signatories in Europe, 27 in North America, 9 in Asia, 9 in Oceania, 4 in Africa and 2 in Latin America. Six of ACSI members have signed up to the UN PRI and three others have advised that they intend to in the near future.

Activities that have been undertaken since the launch of the principles have included:

- Networking among signatories
- The establishment of an e-mail and web-based clearing house
- Enhanced analysis which looks at a strategic alliance to showcase the best sell-side analyses to PRI signatories
- Implementation support
- Mercer have been appointed to conduct an annual assessment of progress which will result in a name and fame focus on good practice.

- Working on a platform for distilling cutting-edge academic research into a practitioner-oriented format

In terms of what the PRI means for super funds:

- Global norms are now emerging
- A global community is forming
- Resources are coming online
- Asset managers are responding

In terms of outcomes from the PRI it is anticipated that participation in the PRI will result in -

- Better information and analysis
- It will be easier and cheaper for superannuation funds to change the market, rather than just accept it
- The services super funds need will be available
- Systemic, higher-level issues will be easier to address.

James concluded by explaining the reasons for funds to sign up to the PRI include:

- Contributing to a more long-term oriented, transparent, sustainable and well-governed economy
- Using the PRI as a framework for development of your own policies
- Being part of a global network of investors sharing experiences on ESG issues
- Gaining access to engagement opportunities and knowledge bank
- Receiving implementation support
- Showing that your fund is addressing these issues seriously and in a way that is consistent with fiduciary duty

If you would like a copy of James' slides simply contact Chris Dardoumbas on 03 9657 4375 or [cdardoumbas@mail.ifs.net.au](mailto:cdardoumbas@mail.ifs.net.au) or for further information regarding the UN PRI visit [www.unpri.org](http://www.unpri.org)



Australian Council of Super Investors Inc.

## CORPORATE CITIZENSHIP NEWSLETTER

December 2006 : Issue No.27

### ACSI SIGNS UP TO UNPRI

ACSI has now signed up to the UNPRI and we've also been active in encouraging our members to do so, so that there is a common platform among members to debate and potentially engage on ESG issues.

As we make our first steps down the broader ESG path we need to understand what ACSI members are currently doing to mitigate ESG risk, so we can consider how ACSI can best support you in terms of implementing the PRI (where applic.) and in broader terms in relation to the mitigation of ESG risks.

We will be in touch with each of our member funds to set up a time to meet (in person where possible) to conduct a Gap Analysis survey to help us to identify areas where ACSI can assist members to mitigate ESG risks. We look forward to meeting with each of you in the near future.

To assist us with our endeavours in this broader sphere we are very pleased to note that we have appointed Meredith Squires to the role of Research Officer (Engagement Support) who will be responsible for developing and supporting the implementation of ACSI's ESG Engagement Program. Meredith started with us on 20 November 2006.

Meredith has worked for EPA Victoria and has also previously worked in private legal practice and for a financial institution in a legal capacity.

### AUSSIE CARBON DISCLOSURE PROJECT

*Australian and New Zealand companies participate for the first time in the Carbon Disclosure Project*

The Carbon Disclosure Project (CDP) is the world's largest collaboration on the business implications of climate change. It involves institutional investors collectively signing a single global request for information on greenhouse gas emissions.

The CDP was launched in December 2000, with 35 institutional investors sending a letter and questionnaire to the FT500 largest companies in the world on 31st May 2002.

Now in its fourth year, the CDP 4 information request was signed by 225 institutional investors with assets of more than US\$31 trillion and was sent to 2180 companies in February 2006. More than 940 companies answered the questions, and from the FT500 sample 91% of corporations responded and 72% answered the questionnaire in full. The responses, and reports based on these responses, are available on the CDP website: [www.cdproject.net](http://www.cdproject.net)

This year the survey was extended for the first time to Australian and New Zealand companies. The Investor Group on Climate Change partnered with the CDP to survey the companies listed on the S&P ASX 100 and the NZ50. The S&P ASX 100 makes up 77% of the S&P All Ordinaries and the NZ50 makes up 97% of the New Zealand Stock Market.

The Australian report was launched on 17 October 2006, and was co-sponsored by the Investor Group on Climate Change and Goldman Sachs JB Were.

57% of Australian companies and 39% of New Zealand companies responded to the information request. The report states that: "This level of response is in line with CDP and IGCC expectations given that this is the first year Australian and New Zealand companies have been surveyed and provides a clear indication that companies are responsive to investor interest in climate change related issues, risks and opportunities."

The key findings of the Australian and New Zealand report were:

- While 94% of respondents recognise the potential for climate change related issues to impact future earnings, liabilities or the company's general risk profile, only 25% of respondents demonstrated a sophisticated understanding of climate change related risks.

- Regulatory uncertainty is an issue for many companies, especially in Australia where the Kyoto Protocol has not been ratified and there is no national emissions trading scheme.
- The strategic and financial impacts of future climate change regulation are complicated and difficult to quantify for many companies, with 72% of respondents demonstrating an awareness of existing climate change regulation, but only 16% showing a sophisticated understanding of the financial and strategic implications for their business of existing and potential climate change regulation.
- Extreme weather events and other physical risks significantly impact (often adversely) many Australian and New Zealand companies. The survey findings indicate that physical risks are of potential significance to 84% of companies, with 56% of respondents describing the nature of these risks in detail.
- The majority of companies do not have clearly defined internal accountabilities for climate change related issues.
- Few companies fully quantify and verify emissions from owned and controlled entities. Only 9% of respondents provided full reporting disclosure of their emissions supported by third party verification.
- Most emission reduction initiatives do not have clearly defined targets and timelines. 67% of respondents have some form of emissions reduction strategy under development or in operation, but only 9% have established formal greenhouse gas emission reduction targets with corresponding and clearly articulated timelines.
- Low participation in emissions trading schemes. 61% of companies do not have an emissions trading strategy.
- Few companies demonstrated a sophisticated understanding of the implications of energy pricing changes on profitability.

The report also analysed the climate change related issues for the following industry sectors:

- Energy – oil, gas and consumable fuels including exploration and refining activities
- Materials – metals and mining
- Utilities
- Financial – commercial banks
- Financial – insurance
- Telecommunications
- Industrials
- Consumer staples – beverages, food and staples retailing, food products
- Materials – construction materials, containers and packaging
- Financial – real estate development, management and property trusts
- Consumer discretionary – hotels, restaurants and leisure, media, retailing
- Information technology
- Healthcare

The report contains an Australian and New Zealand Climate Leadership Index. The Index aims to include those companies who provide CDP responses that most adequately address the key areas of climate change risk and opportunity that have the potential to affect their business. The Index took into account a range of evaluation factors to provide examples of leading practice across a range of industry sectors.

A copy of the full CDP4 Australia report can be found at:

[www.cdproject.net/cdp4reports.asp](http://www.cdproject.net/cdp4reports.asp)

**FROM THE MOUTHS OF BABES – A TEENAGER’S VIEW OF CLIMATE CHANGE**

Article by Patrick O’Sullivan (following his review of Al Gore’s Book – *An Inconvenient Truth*)

Over the last fifty years the environment and its condition has been deteriorating at a rapid rate. The extent of destruction has worsened and the need for action now has



become more evident. This essay will explore the causes of the deterioration of the earth’s quality and what the consequences will be if we are not able to limit our greenhouse gas emissions. We, as a whole human race often ignore our actions that may affect the environment in the future so as a result the quality on earth is slowly deteriorating. If we are not able to act now then the consequences in the future will be somewhat devastating.

The main cause of global warming is our excess amount of emissions of green house, and especially carbon dioxide gas emissions. The thin layer that covers the earth is called the atmosphere. When the sun lets off radiant heat it passes through the atmosphere and onto the earth’s surface. This heat is then re-radiated back into space in the form of infrared waves. Under normal conditions the atmosphere traps a small portion of these infrared waves. This keeps the air at a very liveable level. However, due to excess emissions of carbon dioxide the atmosphere is thickening thus trapping more infrared waves. As a result the temperature on earth and in water is increasing at a dangerous rate.

Another cause of the deterioration of our environment is the burning and logging of forests. This is causing the death and extinction of living species to increase at an alarming rate. At this rate the death of all living species is eminent. The death of these living species is comparable to the extinction of dinosaurs over 65 million years ago. The only difference is the killer 65 million years ago is believed to have been an asteroid. The only killer today is the 21<sup>st</sup> century is us, human beings.

Nature is taking a radical step in the wrong direction as a result of such action as logging trees and using green house gasses excessively. Some consequences of our actions include the increasing problem of melting ice, drought and also heatwaves. Also if climate continues to change hurricanes will be a more frequent occurrence and may carry more force than that seen by the people of New Orleans in Hurricane Katrina. Another, possible fatal consequence of global warming is the increase in water levels. If the climate continues to increase water levels could rise up to twenty feet, which would ultimately wipe out small towns or countries that live on sea level.

In conclusion it is strongly believed that climate change is the biggest issue in society today. This essay has just touched on what causes global warming and just some of the effects that are a consequence of climate change. We cannot just sit back and wait for the time when the problem is out of control because that time is now. If we want our children to live safe lives then we must act now to save what is to come in the future.

*\*Patrick O’Sullivan is the son of David O’Sullivan, Director of LUCRF and Partner of IFS Legal.*

**OVERSEAS DEVELOPMENTS**

**US**

***UnitedHealth Group addresses governance deficiencies***

In a move to improve accountability in light of the options backdating scandal a US company UnitedHealth Group have formed a Nominating Advisory Committee.<sup>3</sup> The committee will provide the Board with recommendations and input into its search for new directors. The Committee will be composed of representatives from the shareholder and medical communities in addition to retained the professional services of a firm to also assist with this search. For further information visit

[http://www.unitedhealthgroup.com/news/rel/2006/1108\\_Personnel\\_Governance\\_Actions.htm](http://www.unitedhealthgroup.com/news/rel/2006/1108_Personnel_Governance_Actions.htm)

***Executive's not immune to peer pressure when it comes to pay***

For a really interesting read about the use of peer group comparisons for executive pay in the US take a look at this New York Times article:

[http://www.nytimes.com/2006/11/26/business/yourmoney/26peer.html?\\_r=1&n=Top%2fNews%2fBusiness%2fColumns%2fGretchen%20Morgenson&oref=slogin](http://www.nytimes.com/2006/11/26/business/yourmoney/26peer.html?_r=1&n=Top%2fNews%2fBusiness%2fColumns%2fGretchen%20Morgenson&oref=slogin)

The article explains that the current disclosure rules in the US require neither the identification of companies in a compensation-related peer group nor the rationale behind their selection. Usually, the most a shareholder learns about companies in a compensation peer group is that they are in the same industry or of a similar size.

"...according to a handful of pay experts who are privy to the design of pay practices

at the nation's largest corporations, many of these peer groups are populated with companies that are anything but comparable. They also say corporate managers ... are selecting which companies make it into a peer group. And because these companies are often inappropriate for comparison purposes, their use has helped inflate executive pay in recent years."<sup>4</sup>

The disclosure rules however are set to change when new Securities and Exchange Commission (SEC) disclosure rules come into effect on 15 December 2006. The rules will require a corporation to reveal which companies it uses in its peer group and to provide an extensive description of its compensation philosophy.

Under the new rules, company officials will also have to certify the accuracy of their pay disclosures.

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This newsletter is correct to the best of our knowledge and belief at the time of going to press. It is, however, written as a general guide so it is recommended that specific professional advice is sought before any action is taken

<sup>3</sup> Global Proxy Watch, Vol X No 42, 10 November 2006

<sup>4</sup> The New York Times, 'Peer Pressure: Inflating Executive Pay', by Gretchen Morgenson, 26 November 2006