A C S I
Australian Council of Super Investors Inc.

CORPORATE CITIZENSHIP NEWSLETTER

October 2005 : Issue No.21

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UPCOMING EVENTS

ACSI AGM
Monday 14 November 2005

5pm - 6.30pm at HESTA Boardroom, Level 28, 2 Lonsdale Street, Melbourne, VIC, 3000
Guest Speaker: Dean Paatsch, Director Operations, ISS Proxy Australia

6.30pm onwards dinner Water and Grass Restaurant, Upstairs Function Room, 32 Bourke Street, Melbourne.

RSVP **7 November 2005** for AGM and dinner to cdardoumbas@mail.ifs.net.au

CSR Seminar
Wednesday 23 November 2005

2.30pm at Cbus/STA Boardroom on Level 28, 2 Lonsdale Street, Melbourne, VIC, 3000.

Dr Leeora Black of the Australian Centre for Corporate Social Responsibility will facilitate a discussion about the discussion paper 'Corporate Social Responsibility: Guidance for Investors' highlighting the key issues for ACSI and our members going forward in relation to CSR. This seminar aims to assist super funds, their staff and Trustees to deal with CSR considerations in the context of their investments.

RSVP **14 November 2005** to cdardoumbas@mail.ifs.net.au

ICGN CONFERENCE EDITION

Constructive dialogue to promote long term value

The International Corporate Governance Network (ICGN) 2005 Annual Conference "Constructive dialogue to promote long term value" was held in London in early July 2005 and attracted an audience of over 500 from over 30 countries and set a standard of debate and dialogue on leading edge issues such as cross border regulation, investor governance, auditing and accounting and board responsibilities, which we are determined to match when we meet again next year in Washington.

The morning of the first day of the conference was marred by the bombings in London. It was remarkable that the conference was able to proceed in light of these events.

There was a reasonable Australian superannuation fund contingent to the ICGN that included Michael O'Sullivan and Phil Spathis of ACSI; Ann Byrne, CEO, UniSuper; Steve Gibbs, CEO, PSS/CSS; and Robert

Fowler, Investments & Governance Manager, HESTA Super Fund.

As always with conferences such as these, a key benefit of attending is the networking opportunities with pension fund representatives across the globe.

Phil Spathis has written the following overview of the conference form his perspective. We believe it provides some useful insights to overseas corporate governance developments and activism and also directs readers to some worthwhile papers.

Future directions for ICGN

The opening session of the conference brought together two internationally acclaimed experts in corporate governance Adrian Cadbury and Ira M. Millstein.

Adrian Cadbury is the retired Chairman of Cadbury Schweppes. He was responsible for publishing a pioneering Code of Best Practice in December 1992 for corporations listed on the London Stock Exchange.

Ira Milstein is a senior partner in international law firm Weil, Gotshal & Manges LLP. In addition to practising in the areas of government regulation and antitrust law, he counsels boards on corporate governance.

Their discussion paper drew on issues identified in a paper "The New Agenda for ICGN"[1]. **Part 1 of the paper provides a useful short history of corporate governance with particular focus on Boards. Part 2 of the paper provides a useful discussion on the direction of corporate governance.** For a complete copy of the paper visit http://www.icgn.org/conferences/2005/documents/cadbury_millstein.pdf

In their view future direction of research and engagement needs to take into account some of the following failures:

- Not enough boards have taken 'best practise' corporate governance seriously except as a box ticking exercise;
- Regulatory reform has been watered down by political interests;
- Because of institutional lethargy and conflicting goals and objectives, active shareholders have been limited to a few public funds and mutual funds;
- A disparity of shareholder objectives;
- CEO compensation tied to immediate results;
- Gatekeepers, such as lawyers and accountants blinded by loyalty to management team;
- Whistleblowers are not adequately protected;
- Accounting rules becoming so complex.

In summary Milstein and Cadbury propose that:

- Boards need to be reminded that they are fiduciaries for other people's money and therefore bound to create operation management capable of producing what their shareholders value and who respect the rights of corporate investors.
- Board governance and faithfulness to this fiduciary duty must be enforced through the rule of law.

Institutions need to have credibility, as responsible guardians of other people's money. This starts with voting, they should avoid intermediaries with conflicts of their own, avoid overly rigid box ticking and to get to know the companies and the boards that they invest in.

The paper then goes into areas where the ICGN should itself undertake strategies to assist a credible institutional voice from an investor perspective, and to deal with such issues including:

1. conflicts;
2. investment horizons;

[1] Discussion Paper No.1 for the ICGN 10th Anniversary Conference, London 'The New Agenda for ICGN, by Adrian Cadbury and Ira M. Millstein'

3. internal governance;

4. regulation.

With respect to priority issues for boards, the paper proposes a road map for reform, that includes improvements to the election processes that apply to directors (this is a particularly contentious issue in the U.S) and issues in relation to compensation, remuneration and financial statement disclosure.

A useful outline of several challenges for Boards was advanced by Ira Milstein:

1. **Establish an appropriate 'tone from the top' on ethics and business conduct** - The 'tone from the top' should be apparent in every corporate action and corporate communication;
2. **Deal effectively with executive remuneration** - 'astronomic compensation should only follow astronomic performance';
3. **Recognising the fine line between oversight and micro-management** - Effectively the foundation of corporate governance is 'constructive tension' between the board and management;
4. **Creating meaningful independent board leadership** -A CEO cannot be an effective leader in monitoring their own performance or questioning the assumptions underlying their own proposed strategy;
5. **Understanding that the fiduciary reform dynamic has slowed but not ended** - Corporate America remains only a major scandal or two away from another round of regulation. Therefore a narrow approach to corporate governance is general in response to scandal is undesirable;
6. **Taking the initiative in shareholder relations** - The regulatory pause should provide an opportunity for corporations to improve voluntary relationships with shareholders;
7. **Keeping apprised of the evolving standards for director liability.**

Various international perspectives on corporate governance activism

The exchange between activists from Korea, Canada and the Netherlands was interesting in terms of the different perspectives on corporate governance activism.

The **Canadian** activist considered that institutional investors can do a better job in monitoring corporations and spoke at length of the importance of collective action.

He talked about the Canadian Coalition of Good Governance (CCGG), which is a body of 45 institutional investors that includes fund managers, mutuals and pension funds, who manage close to $800 billion Canadian. The CCGG has been an important governance advocate and opinion leader in Canada on corporate governance and in the view of the presenter represented a good reason why it was an imperative for a national organisation for share owners to be created to create a co-ordinated effort on corporate governance amongst institutional investors.

With respect to **East Asia**, whilst regulations on corporate governance have recently been formulated across many jurisdictions, coupled with training of corporate directors, much still needed to be done to promote the principles of good governance to be embraced and applied across different sectors.

Regulators have laid the basis for corporate governance reforms and have supplemented private initiatives largely from central banks, securities and exchange commissions and other regulatory bodies across China to Indonesia.

Private and non-government initiatives are increasing complementing the efforts of regulators.

It is recognised that regulators and regulations can only go so far.

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In areas where the enforcement environment is weak, private or non-government initiatives are of much greater importance with respect to corporate governance reform.

Whilst there have been some improvements in these jurisdictions, many local institutions are still conflicted and foreign institutions are not vocal enough.

With respect to **Europe**, there is a view amongst many boards that they believe they once operated in "splendid isolation", and are now disturbed by shareholders turning up and voting and voicing an opinion.

Shareholders need to get involved on key macro-issues where management are conflicted themselves, i.e. with respect to remuneration and takeovers.

There was some discussions about the role of independent directors. Shann Turnbull from Australia asserted that there was a misuse of the term "independent director", that directors are only independent if they have the will, power and information to act independently of management.

There was some lively discussion in relation to the role of an independent director particularly where a dominant shareholder and/or founding shareholder exists.

The European representative also spoke about the need for independent directors to have a strong will to deal with major "blockholders"/shareholders who have a significant financial relationships with the company, particularly through related party transactions.

It was widely acknowledged across the globe that many shareholders are struggling to deal with corporate governance issues in family owned companies.

According to Adrian Cadbury, there are two key issues with respect to such companies that become publicly listed.

1. it is critical that they bring in outsiders as the company grows and moves from a "partnership" approach to forming a board. This is involves a separation between the governance of the company from the governance of the family.
2. the board also brings about critical issues of succession, and getting succession policies right with respect to leadership of such companies.

There was also discussion about how institutional shareholders should explain how they vote and why they vote.

Presentation by Congressman Oxley

The co-author of the Sarbane Oxley legislation, Congressman Michael G Oxley, went through details of the investor protections and higher standards for corporate governance that has been applied in the US in response to the business scandals.

The legislation is regarded to be the broadest piece of federal legislation to address corporate governance since the adoption of the Securities Exchange Act in 1934. It sets in place provisions with respect to the disclosure of off balance sheet transactions and contingent liabilities, the use of non-**Generally Accepted Accounting Principles** (GAAP) in the US financial information, protection for corporate whistle blowers, the adoption of code of ethics for chief executives and senior financial executives, audit committee independence and responsibilities, independence of outside auditors and review and certification of internal controls.

As the Chairman of the House Financial Services Committee, he led an extensive investigation into the accounting scandals of these rogue companies. He worked with Senator Paul Sarbanes to develop the Sarbanes-Oxley Act (SOX), a sweeping corporate accountability bill signed into law by President Bush on 30 July 2002.

He spoke in detail about SOX that requires CEO certification of financial statements, mandating real-time disclosure of information important to investors, and establishing an oversight board for the accounting industry.

In his view the SOX was an example of American economic resilience that is, the ability of their system to reform, move forward, solve problems, and become more efficient. In his opinion no economic system in the history of the world could withstand the impacts of -9/11, the corporate scandals, the bursting of the tech bubble-and emerge stronger for it.

The US SEC has been required to adopt the SOX provisions and to police these provisions across the US.

There was some discussion about the merits and costs of compliance to a rule based approach, as opposed to a principle based approach exemplified in the UK and to some extent in Australia.

In Congressman's Oxley's view, the financial fraud discovered at companies like Enron, WorldCom, Global Crossing, and others was intolerable because it struck directly at the integrity of the US equity markets and capitalist system.

Oxley recognised that nearly half of all American households have investments in the stock market. He made it clear that he regarded that it was unethical and corrosive to the system when corporate "insiders" were able to profit at the expense of an average investor saving for retirement or a child's education.

There was also some discussion of the pressures that have emerged from the corporate sector on regulators to "roll back" such legislation.

Globalisation of corporate governance regulation

The debate then broadened to the area of globalisation of corporate governance regulation.

There are inevitably differences between countries on corporate governance regulation that reflect their culture, traditions, assumptions and attitudes.

In the UK, the role of government is more an enabling one, to provide a framework for corporations through the rule of law. Companies are encouraged to be established, meet regulatory requirement and then proceed to make a profit, and then proceed to pay tax. Government regulation has generally tended to arise as a consequence of a crisis. The UK laws are better described as soft laws that rely on markets to enforce them, like the takeover panel and combined codes.

In the US there are no federal corporations acts, so States compete for companies favour which has been described by an ex chairman of the regulator, the SEC as "a race for the bottom", so that individual States compete to get companies to register them. Hence, the esteemed position of the State of Delaware.

The SEC in the US supposedly must act in a manner that overcomes states rights issues and addresses issues relating to the efficient and honest operation of markets.

In continental Europe, such as Germany, there still exists a dominant paradigm of collective responsibility at both managerial and supervisory levels.

The question was posed as to whether it was possible to seek an international set of corporate governance legislative regimes. There was an overall view that one needs to tread carefully. Reference was made to various European Economic Community (EEC) directives that tried unsuccessfully to impose uniform board structures across member countries.

OECD principles on corporate governance were also discussed.

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Active ownership strategies within and across borders

The Former Chief Justice of the Delaware Court, the Honorable E. Norman Veasey set the scene with respect to the expectation of shareholders on active communication, voting and engagement strategies.

He spoke at length about the flexible and business friendly jurisdiction of the State of Delaware and their emphasis on 'fiduciary' orientated legislative provisions that are largely principle based. This represents a less compliance driven regime, but puts a significant reliance on boards and directors to exercise a judgement in the best interests of a corporation. He spoke about the formulation of the "business judgement rule". By way of background, courts have traditionally deferred to the business judgement of directors ie whether directors have acted in good faith, with loyalty to the corporation, an on an informed basis. Courts are also mindful that shareholders have elected the directors- not the courts – to supervise the affairs of the corporations they own.

Veasey referred to the case of *Brehm v. Eisner*, a case involving the Walt Disney Company's very large severance payment to its former President. The Deleware Supreme Court repeated the traditional formulation of the business judgement rule as a "presumption that in making a business decision the directors…acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the corporation". The court went on to say that directors decisions will be respected by courts unless the directors are interested or lack independence relative to the decision, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available."

Veasey rejected a contention by the plaintiff shareholders that courts should review whether directors had failed to exercise "substantive due care". He considered that the concept of "substantive due care" is "foreign to the business judgement rule. Courts do not measure, weight or quantify directors' judgments. We do not even decide if they are reasonable in this context.

Due care in the decision making context is "process due care" only. Irrationality is the outer limit of the business judgment rule".

He also spoke about the work that the "Blue Ribbon" Commission was doing with respect to board responsibilities. The Commission is an organisation not unlike the AICD that focuses on board education.

US rules on director elections

Debate ensued about possible changes to the US Model Business Corporation Act with respect to voting for directors. The rules with respect to director elections is regulated by State corporation law.

As reported in ACSI's Newsletter Edition 20, the American Bar Association Committee of Corporate law has released a discussion paper with respect to voting for directors of public companies.

It refers to the default statutory rule of the Model Act that provides that "Unless otherwise provided in the articles of incorporation, directors are elected by a plurality of the votes cast." A plurality (or "relative majority") is the largest share of something, which may or may not be a majority. For example, if an election had three candidates, who received 40%, 25%, and 35% of the vote, the candidate with 40% would have a plurality, but not a majority. The best-known plurality method of election or voting is the First Past The Post system.

The Committee has considered the various alternative scenarios and their consequences that include:

- Retaining the current plurality vote default rule
- Change to a majority vote default rule

- Adopt a default plurality rule requiring that a director must be elected by at least a "minimum" plurality vote, such as one third
- Leave the plurality vote default rule in place but specifically authorize "against" vote with the consequence where a director achieves a plurality vote but more "against" than "for" votes. These consequences could include, for example shortening the term of that director, unless the board acted within a specified time frame to confirm the director's election, or giving the board the authority to remove that director.

Not surprisingly, in a straw electronic vote at the conference the majority of attendees supported a majority vote approach.

Other matters raised by various speakers in this session included:

- Representatives from CALPERS reiterated their strong view that companies that embrace good corporate governance practices perform better and also referred to a McKinsey [2] study that affirmed the same thing. Adding value can occur by improving shareholder rights, addressing malfunctioning boards and properly addressing executive remuneration.

  See article in US Journal of Applied Corporate Finance
- With respect to Private Equity and corporate governance there was a view that this provided the following attributes:
  - Alignment of interest;
  - Smaller shareowner base;
  - Focus on long term value.

Executive remuneration: has anything changed?

Essentially the workshop provided a contrast in the state of remuneration policy and practices in Europe and the United Kingdom and the U.S.

US

The consensus view of the US is that the most fundamental reason for overpayment of CEOs, is where the role of CEO and Chair is combined as chairs have too much power and use it. Boards in the US are commensurately weaker, and/or are over-rewarded themselves in order to maintain their silence on the issue of executive remuneration.

There is nothing on the horizon to curtail excessive payments. The only thing that could curtail this excess is the SOX and various prosecutions for malfeasance have strengthened disclosure to some extent.

When an executive is hired, there is a contemporaneous disclosure of the terms of their contract. However, according to Keith Johnson from the State of Wisconsin Investment Board the real issue to look at is the frequently undisclosed retirement benefits which in one case resulted in the retired CEO and wife, earning more per annum than he received for the rest of his/her life. Such a payment would continue passed the ex-CEO's death resulting in the widow inheriting the full amount.

This situation seems to be hampered by the relative weak position that shareholders have to remove directors. Therefore the board members who agree to these things cannot be punished and it only encourages a wages spiral amongst the club.

UK and Europe

In the United Kingdom, unlike the US there are cultural and moral consensus about excess. Earlier Bob Monks said that **the reason for excessive payments to US CEO's is "Power period; CEO's have the power and they use it".**

[2] http://www.oecd.org/dataoecd/56/7/1922101.pdf

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In the UK and Europe, they are infected by the US practice of excessive payment but it is not as pervasive as the US because boards are stronger and the separation of the role of CEO and Chairperson.

Again Bob Monks made the following point about the British company Vodaphone taking over a German company. The CEO of Vodaphone was offered ₤11 million bonus for the successful merger. There was a public outcry in the "city" and the CEO declined the majority of the bonus. Monks says that if the same thing happened in the US, the CEO would have replied, "I don't understand about all that, talk to my lawyers". Monks says that the only consensus in the US is about the law. There is not moral or cultural consensus above what is required by law.

The lesson for ACSI is to promote and foster cultural and moral considerations about excessive remuneration.

The UK experience of non binding resolutions has been twofold. There has been a great deal of consultation with institutional shareholders about quantum and structures and there has been greater restraint than is evident in the US. Peter Montangon of Association of British Insurers who was for many years a senior financial writer for the Financial Times made the point strongly that it is very difficult to second guess from outside the company as to what is the appropriate quantum for a particular CEO. It easier to detect gross excess when you see it, but it is far more difficult to identify what precisely should be the reward for a particular CEO in one company relative to others.

His solution is to elect and monitor the Boards and keep the general pressure on Boards to remunerate fairly or appropriately.

People are sceptical about the alignment of interests arguments, but no one has come up with a better model, few companies have been bold enough to 'break away' from the pack, for fear of losing or not attracting quality leaders.

Accountability and responsibility in the boardroom: making it happen

Session leader Pat Canavan, Vic President, Motorola said that Motorola accepts that the Board is responsible to shareholders. However the shareholders are the institutional investors and so the actual relationship is not with shareholders, but with the analyst staff of the institutions who are tracking Motorola.

This could be unsatisfactory because the proxies of the shareholders may be conflicted and not have the same interests as the beneficial owners of the shares. The fund manager could be looking at different outcomes from the long-term investor.

Motorolla provide briefings to analysts, but the outcome is only a few paragraphs in the report. The headline in the analyst reports is the short-term performance figure.

There are three things that drive director behaviour in the US:

1. Reputation-not trashing their reputations
2. Litigation which is enormously distracting and consumes an inordinate amount of their time;
3. Bankruptcy for being found liable for being asleep at the wheel and being found to be negligent and sued for such negligence. Other companies could become timid if they witness these sort of treatments of fellow directors.

Sir David Clementi of Prudential made the point that Ira Milstein had talked about, that institutional investors do better by talking to companies behind closed doors.

That is ok within certain limits, but there are severe legal limits to saying certain things to one group of shareholders, and not to all.

He likes the "if not why not approach" and where tolerance for explaining differences is needed. That companies in different markets have different considerations. For example finance house compared to a resources company.

On the difference between US and UK, additionally to the fused chair/CEO role in the US, there are fewer executive directors on Boards in the UK.

The representative from TIAA-Cref saw themselves as quiet persuaders and that when this fails they propose resolutions. For example, they are against 'dead hand' poison pills that are not subject to shareholder approval. On the issue of share price and whether this should be the only criteria of real concern to pension funds, she said that it wasn't, the long term value of the company was important.

Ann Byrne from Unisuper effectively asserted that the overriding duties of trustees is to increase member wealth and therefore share price is a major concern. Ann then gave a good elaboration of the formation and purpose of ACSI as a means of maximising the influence of pension funds on governance. She made the point that her members, employees of universities, are concerned about the triple bottom line considerations. She also queried whether the analysts who monitor the company are capable of or are interested in analysing triple bottom line issues.

Corporate governance private interest and the public good

This was a presentation from Bill Wetherall of the Organisation for Economic Co-operation and Development (OECD) who presented in lieu of Don Johnston who could not attend the conference because of the bombings.

He outlined the OECD's work on corporate governance and the development of the first generation OECD Corporate Governance Principles as an expression of 'world standards' on the subject matter.

Efforts have been made to extend the Principles beyond OECD nations to Russia, South Eastern Europe, South America and Asia.

Post-Enron they identified the following issues:

- The separation of the roles of Chairman and CEO;
- The use of poison pills;
- One share one vote;
- Auditor rotation.

The OECD had established a stakeholder dialogue forum and have updated the Guidelines to take into account the abovementioned concerns.

The OECD have revised their guidelines and these are available on the OECD website www.oecd.org.

RESIGNATION OF DIRECTORS[3]

By Henry Bosch

The resignation of three directors from the board of the Strathfield Group has reopened the questions of when, and in what way, dissatisfied directors should resign. The Chairman of Strathfield and two colleagues issued a release to the ASX in which they said "we are concerned the Board may not, in the short term, conform to best corporate governance practice….or that, if we were to remain, we would be in a sufficiently strong position to improve those corporate governance practices to an acceptable extent." The ex-chairman is reported to have said, in a subsequent interview, "We could have sent out the usual one line statement but we just wanted to explain why we were leaving. I think we wanted to explain to shareholders that the structure wasn't right on the board."

Directors who decide that something seriously wrong is happening are in a difficult position.

Of course their duty is to act in the best interests of the company as a whole and in almost all circumstances that will mean staying on the board and pressing for what

[3] First published in the Board Report of the Company Directors' Association

they believe is right as long as there is any reasonable chance of improving the situation.

But if they come to the conclusion that the board is determined to do something that is illegal or disastrous or even just very stupid, or that proper consideration will not be given to important issues, how should they act in the interests of the company?

Should the shareholders, or ASIC, be informed, and if so how much information should be given? Directors in such a situation would have to consider whether a statement could damage the company in the short or long term, for instance by depressing its share price. Then they would have to reflect on how much information they could reveal in the light of their duty of confidentiality; and it would be quite reasonable for them to have regard to the possibility of a defamation action.

These considerations go quite a long way to explain why it is standard practice in Australia for directors to issue a one line statement without any reasons for resignation. That is, at least, better than the all too common platitudes about "pursuit of other interests" or "excessive workload" or, in many cases "health", which are often the excuses of cowardice: a reluctance to be unpopular or a lively recognition that candour may reduce the prospects of invitations to other boards.

If a director has decided that his duty requires that something be said, how much detail should be provided? The three directors of Strathfield have given a very general warning which could not have breached confidentiality nor exposed them to a defamation action – but which does not give shareholders much to go on.

Their statement is reminiscent of that of Mr Cousins who resigned from the board of Hudson Conway in 1998 on grounds of business ethics and proper corporate governance which he refused to explain to the ASX unless he was given qualified privilege – which was not available.

A far more specific reason was given by Sir Ross Buckland when he resigned from the board of the Mayne Group in March 2004.

He identified a board decision which he believed was "not in Shareholders' interests" and said that he had "no alternative but to further reinforce my level of concern by resigning from the Board." Even more forceful and explicit was the lengthy letter of resignation from Professor Vizard to the Chair of Australian Wool Innovation Ltd in June 2002. He detailed "the repetitive provision of inaccurate and incorrect information to the Board" and argued that the last AGM had been turned into a sham which had "seriously undermined the rights of shareholders." Professor Vizard's letter contrasts with that of Mr Bob White who resigned from the board of Westpac in 1990 with a very muted letter, but who spoke out two years later after a disaster which led to the resignation of four of his former colleagues. He was then quoted as saying "I'd lost confidence in the direction of the bank under the existing leadership at the time, but I didn't seem to get any support. I just did what I thought was my duty."

Does resignation have any effect? The campaign waged by Roy Disney and Stanley Gold forced Michael Eisner to stand down as Chairman and CEO of the Walt Disney Company, but such dramatic events have few parallels in Australia.

Professor Vizard forced major changes at AWI and his concerns were aired in detail to a Senate Committee, but Sir Ross Buckland's departure from the Mayne Group was almost unnoticed – perhaps because shareholders did not think his grounds were sufficiently strong.

The three resignations from the Strathfield Group appear to have resulted in a sharp fall in the share price, but the confused situation at that company makes it difficult to be sure.

The law opens an alternative to a statement to shareholders: Section 205A of the Corporations Act already provides that a director <u>may</u> give ASIC notice of resignation

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accompanied by a copy of his letter of resignation to the company, and clearly legislation could go further.

It might be reasonable for directors to be required to explain their reasons for resignation to ASIC in confidence, but it would probably be going too far to make resignation conditional on obtaining ASIC's permission.

The readiness of many Australian directors to walk away from their responsibilities as soon as the going gets tough has led to several demands that the law be strengthened, but self regulation offers a better route. A clearer lead from the ASX Corporate Governance Council would be a good start; already its Recommendations outline best practice for directors' letters of appointment and these could be expanded to include guidance on appropriate procedures in the event of serious dissent. The director's reasons for concern should be set out in writing to the board and only if all hope of an agreement is impossible should consideration be given to sending a copy, perhaps with confidential information excised, to shareholders or ASIC.

APRA PROPOSES NEW PRUDENTIAL FRAMEWORK FOR GOVERNANCE

On 18 May 2005 APRA released a discussion paper 'Governance for APRA - regulated institutions' for authorised deposit-taking institutions (ADIs), general insurers, life insurers and authorised non-operating holding companies (NOHCs). This second discussion paper follows extensive industry consultation, outlines proposals for boards of APRA-regulated institutions to:

- meet composition requirements regarding board size, independence of directors and shareholder representation;
- have a majority of independent non-executive directors, with exceptions for certain types of subsidiaries;
- have an independent non-executive director as chairperson of the board;
- establish a Board Audit Committee and a Board Risk Committee;
- have a policy on board renewal;
- ensure their institutions have a dedicated internal audit function; and
- apply independence provisions for external auditors, consistent with the CLERP 9 requirements in the Corporations Act.[4]

Like the AICD as reported in the recent Company Director Magazine Vol 21 No 6 July 2005, ACSI is opposed to APRA's position in removing the "if not, why not" approach to the recommendations of the ASX Corporate Governance Council Principles. It is currently proposed that APRA may make exceptions in some instances on a temporary basis if a persuasive case is made to it in private.

Submissions to this discussion paper closed on 12 August 2005. We will watch with interest any further developments in this area.

STANDARD FOR SUSTAINABILITY REPORTING ON THE AGENDA

The federal government has asked the Australian Stock Exchange's Corporate Governance Council to consider developing a standard for sustainability reporting, in a significant expansion of the corporate governance debate.[5]

The AFR reported that Federal environment minister Ian Campbell said reporting should remain voluntary as the government was "not in the business of putting more red tape on business".

Around 23 per cent of Australian companies publish sustainability reports, compared with

[4] http://www.apra.gov.au/media-releases/05_29.cfm
[5] AFR 29/09/05 'Call to develop 'genuine' social responsibility'

80 per cent in Japan, 71 per cent in Britain and 32 per cent in the United States.

In terms of existing law in this area under the Corporations Act, some boards must report on their compliance with environmental law. Financial product issuers must disclose the extent that social, environmental and labour standards are considered. This is not to say that this will not change in light of the PJC and CAMAC inquiries.

We understand from the AFR article that the ASX Corporate Governance Council has agreed to consider Senator Campbell's proposals as part of a wider review of risk-management guidelines.

INTERNATIONAL NEWS

US

Small Co's argue SOX too much burden

The US Securities and Exchange Commission has given small public listed companies until early 2008 to comply with the internal-controls rule of Sarbanes-Oxley (SOX).

However, critics of the decision note that small companies have disproportionately more accounting problems. 75% of companies that were the subject of fraud allegations described in SEC enforcement releases from 1998 to 2003 had market capitalizations of less than $700 million, and 40% had market capitalizations less than $100 million.[6]

A survey by proxy-advisory firm Glass Lewis & Co. found that small companies, those with less than $100 million in annual revenue, restated earnings in 2004 at more than twice the rate of the largest companies.

[6] Outside Audit Watchdogs Frustrated By Sarbanes Extension They Say Tiny Companies Need the Internal Controls; It's 'Better to Encourage', By Michael Rapoport, DOW Jones Newswires, 4 October 2005.

But on the other side of the fence, Mr Perkins, Chairman, Nanophase Technologies, a small Illinois-based maker of nanocrystalline materials made the following statements to the SEC outlining the costs of compliance "We have only 50 employees. Three of these are finance and accounting professionals... In 2004 over $259,000 (5% of our sales) was spent and over 1,000 hours were used for us to produce a SOX-404 result that showed no material weaknesses."

Like many biotechs and nanotechnology companies, Nanophase did not earn a profit in 2004. Mr. Perkins said he estimates 2005 to cost about two-thirds of last year. "Because of the one-size-fits-all approach to SOX-404 requirements, an unwarranted and, we believe, unnecessary burden has been put on our small company," he concluded.[7]

SOX is also said to be hurting community banks. "Public community banks are particularly stressed by many of the new securities law changes," some "to the point that it becomes unreasonable to remain public." Said Charlotte M. Bahin, senior vice president of America's Community Bankers.

In light of the concerns being raised by smaller companies and start ups Sens. Bob Dole and Tom Daschle have outlined the following proposed reforms to SOX -

1. Congress could allow smaller companies to be certified every other year or every third year, not annually as currently required.
2. It could focus audits on statements of revenue and lighten the standards for relatively minor items like travel and expense reports.
3. It could allow smaller companies to stop treating options as a compensation expense, since small firms have more trouble keeping talent without options.

[7] Stop strangling startups, Washington Post, Editorial, 4 October 2005

It will be interesting to learn the outcome of these proposals and then to consider the wider implications for smaller companies elsewhere in the globe.

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