



"CORPORATE CITIZENSHIP"

A NEWSLETTER OF
THE AUSTRALIAN COUNCIL OF SUPERANNUATION INVESTORS

ACSI LAUNCHES CORPORATE GOVERNANCE INFORMATION AND EDUCATION SERVICE

ACSI recognises that not all Funds require, or have the resources to review reports on every corporate governance issue that arises in Australian listed companies. Consequently, ACSI has developed, in conjunction with Institutional Analysis, a tailored service that is cost effective and relevant to the needs of Australian Superannuation Funds.

All superannuation funds will be able to subscribe to ACSI's corporate governance information and education service.

This service builds upon the recognition that only 15% of issues referred to shareholders at Annual General Meetings are in fact contentious.

Therefore trustees who do not require advice on the majority of issues that are usually considered as "routine", should find this service well targeted to meet the information, resourcing, and administrative needs of your fund.

The ACSI service will provide Funds to access ACSI's:

- database of S&P/ASX 100 companies that will ensure that you are notified every time a contentious corporate governance issue arises in these companies;
- expert opinion on corporate governance issues you identify in the S&P/ASX 100 companies;
- education and training seminars including a corporate governance "user manual" for subscribers to effectively utilise the service.

ACSI has developed a list of 45 contentious issues that will form the 'trigger' in our database. This list will be continuously updated to ensure that it is relevant to

evolving information requirements of trustees on corporate governance issues.

For more details on the service please contact Phil Spathis on 9657 4386.

ACSI ASSISTS FUNDS TO DEVELOP THEIR CORPORATE GOVERNANCE POLICY

Do you require a copy of ACSI's draft corporate governance guidelines and options paper for trustees?

ACSI's policy options are designed to assist trustees to formulate a practical approach on corporate governance issues.

ACSI officers are also available to address your Board and relevant committees on ways your fund can progress these issues when formulating a policy.

ACSI RESEARCH AGENDA FOR 2002/2003

The ACSI Committee of Management have endorsed, following ACSI's recent inaugural conference, the following research agenda for the 2002/2003 year.

Research currently in progress

- Dual Listing arrangements and Shareholder Rights – A review of the impact dual listing proposals have on share holder rights and the potential

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to entrench board and managerial control.

- A study into the methodology utilised by company remuneration committees when developing remuneration policy for company executives and staff.

Repeat research

- A comparison of results from annual reports and other company statements from the previous two years regarding the independence and composition of Company boards and committees. The study also reviews remuneration practises of the S&P/ASX 100 companies, particularly regarding executive share option arrangements.

Proposed new research

- Identification of contentious corporate governance issues that are relevant to trustees;
- Development of ACSI good Corporate Governance Principles and Guidelines;
- Study into promoting improved financial statement integrity and effectiveness, including ensuring that auditors perform effectively and independently;
- Other related considerations include:
 - Adequacy of financial information provided by the Companies to properly reflect the position of the company;
 - Adequacy about the scope of Auditor activities in corporations;
 - Regulation of Auditing standards;
 - Conflicts of interest;

- Rotation of partners/teams/firms;
- Shareholder say in auditors/audit committees;
- International Accounting Standards.

- A review for Trustees of the regulatory environment that puts in place the corporate governance framework, including:
 - Corporations Law;
 - ASX - listing rules;
 - Other relevant regulations;
 - Industry self regulatory standards;
 - Other mechanisms that provide shareholder redress;
 - Role of ASIC, APRA, ASX in this framework.
- Investing in Cayman Island - due diligence, enforcement of investor rights, consideration of prosecution mechanisms for defalcations;
- Reform of the processes and timelines relevant to Trustee shareholders regarding provision of Company Notices of AGMs and EGMs and the requirements to lodge proxies;
- Development of options for trustees who wish to become active in the corporate governance issues of overseas equity holdings, with particular focus on:
 - Pooled investment vehicles;
 - Discrete or direct investment portfolios;
 - Corporate credit arrangements.

- Options for communicating the importance of corporate governance considerations to Trustees, fund members and community;
- Overseas case studies/experiences of useful activities undertaken by pension funds/investors to bring about positive changes in corporate governance i.e. proxy voting, engagement, policy developments and initiatives;
- Connecting Corporate Governance issues to triple bottom line reporting and SRI considerations.

NOTICE OF ACSI GENERAL MEETING

In accordance with the requirements of the Associations Incorporation Act 1981, ACSI will be convening its Annual General Meeting on 16 September 2002, at 5.00pm, IFS Fairley Boardroom, Level 29, 2 Lonsdale Street, Melbourne.

DINNER AT KRI KRI

Following the Annual General Meeting on 16 September 2002, you are invited to Kri Kri Greek Restaurant, 39-41 Little Bourke Street, Melbourne. ACSI members will have an opportunity to enjoy a banquet dinner and a discussion on a topical corporate governance issue for only \$40. If you would like to attend, please contact Chris Dardoumbas on (03) 9657 4375.

THE PRICE OF EXECUTIVE SHARE OPTIONS

The International Accounting Standards Board recently announced that it will be producing a draft policy on the way share-based payments for employees should be treated on a company's balance sheet. It announced that these standards will apply in 2004.

The Australian Financial Reporting Council has indicated that the proposed international accounting standards would "apply to all Australian companies, trusts and reporting entities from January 1, 2005, at the latest." The Australian Accounting Standards Board has also indicated that it will embrace "in totality" the international accounting standards in 2005.

This raises some important questions:

- Should investors have to wait until 2005 for an improved disclosure and accounting treatment of share options?
- Are our current laws effective in ensuring that corporations reveal the value of remuneration arrangements?

ACSI study reveals inadequate disclosure of share option values by top 100 companies

ACSI's study into executive share option schemes in Australia (S&P/ASX 100 company based on an analysis of 2000/2001 annual reports), has revealed that a number of Australian companies are failing to meet current disclosure requirements that are arguably less onerous than present US standards.

Under section 300A of the Corporations Act, there is a requirement that the directors' report for the financial year for a company must also include "details of the nature and amount of each element of the emolument of each director and each of the 5 named officers of the company receiving the highest emolument." Under these provisions the company is therefore required to disclose the value of all remuneration of the top 5 executive officers and board directors.

In the US, a company is required to disclose the value of options that apply to **every employee** of the company, irrespective of whether they are in an executive category or not.

While both Australian and US law require some form of disclosure in relation to option packages, neither jurisdiction requires the cost impact of those options on earnings to be revealed in the profit and loss of the company's statement.

The current US debate on options focuses on the fact that the disclosure of share option values occurs in the form of a footnote to the annual report, (an equivalent to the notes to financial statements as they exist in Australia) and these arrangements are not expensed in the company's profit and loss statement.

In contrast to Australia, investors in the US can at least ascertain the financial impact of share options against a company's accounts, by deducting the amounts paid for share option schemes from the profit and loss statement. The same cannot be said in Australia.

Our study shows that a remarkable 52% of the top 100 S&P/ASX companies are not disclosing the value of options that are granted to directors and the five highest paid executives in the company as is required by section 300A of the Corporations Act.

Some companies argue that section 300A is ambiguous and does not in fact require disclosure of share option values.

The Australian Securities and Investments Commission has disagreed with this interpretation yet it appears that little has been done to enforce this provision.

While ACSI supports the Commission's Chairman Mr. David Knott's call for option expenses to be included in the company accounts, not enough is being done under existing regulations to enforce disclosure of the value of these remuneration arrangements.

Valuation Issues

Some companies have pointed to valuation difficulties on disclosing the value of executive options granted during the year.

A common approach is the use of the "Black-Scholes" method of accounting.

According to an explanation from the UK Accounting Standards Board (ASB), "the Black-Scholes method provides that options are valued at the end of each accounting period between the time of the granting of the options and the time of vesting (when the option becomes the property of the employee). At the time of vesting, the final value of the option becomes known and the estimates from the previous accounting periods can be adjusted accordingly."

Critics of the Black-Scholes approach argue that the cost of issuing an option to employees is already taken into account as a consequence of the diluted earnings per share when valuing a stock, to account for options.

According to Business Week, the approach to be adopted by Coca-Cola, who have recently announced that it will voluntarily price share option arrangements will involve the engagement of two "Wall street firms to provide binding quotes on options to buy 10,000 shares of Coke stock and options to sell 10,000 shares. The average of the four quotes would be used to determine the options' value, and thus the charge to earnings".

Another approach when expensing share options involves pricing the options at two points in time. Firstly, they could be costed at the time they are issued and then subsequently costed when the options are exercised. When the options are exercised, an adjustment is made to the price, which reflects the actual "cost" to the company for providing the share options.

US response to pricing share option schemes

Despite endorsing a range of accounting reforms, the US Senate has blocked moves that would have enabled the US Financial Accounting Standards Board (FASB) to require proper costing of options on a company's profit and loss statement.

In 1994, the Senate bowed to business pressure and thwarted proposals by the FASB to introduce arrangements that would have required the proper disclosure of the cost of providing share options to employees. Until recently, only two S&P 500 companies in the U.S have voluntarily costed their options, Winn-Dixie Star and Boeing.

Share options form a significant proportion of remuneration for US executives. 58% of US CEO remuneration is made up in share options. Despite the major cost impact of such employee option schemes, these have not been recorded in a company's profit and loss statement.

It is remarkable that a Credit Suisse First Boston study published in 2001 found that the earnings of S&P 500 companies would have reduced year 2000 earnings by 12 per cent had companies priced their options and recorded the impact of options on their profit and loss statement.

Can we wait until 2005?

Some commentators have asserted that Australian companies do not provide the same excessive reward arrangements as in the United States and therefore there should not be a dramatic impact on a company's bottom line if share options were valued and priced.

This claim cannot be confidently made in the absence of adequate information on valuation.

Australian investors cannot currently appreciate the impact of share option arrangements on company balance sheets given that a number of Australian companies do not disclose the value of share option arrangements.

Investors should not have to wait until 2005 for improved disclosure practices. A number of measures need to be considered by the Government and regulators. This includes:

- Vigorous enforcement of section 300A of the Corporations Act by ASIC;
- Unequivocal reaffirmation of the original intent of section 300A by the government;
- Immediate introduction of legislation ensuring that share option arrangements and other types of remuneration are properly disclosed and costed by companies;
- Encouraging companies to voluntarily price their share option arrangements without waiting for legislative action.

Identifying which Australian companies disclose share option values in accordance with Section 300A

ACSI believes that those companies that currently meet the requirements of section 300A should show the lead and also voluntarily expense share options in their profit and loss statements.

Those companies that do not currently value executive share option arrangements, should be made aware of investor concerns, and should also be mindful of their obligations under section 300A.

Attached to this newsletter, is information provided strictly to ACSI members listing those companies in the top 100 S&P/ASX companies that currently value executive share option arrangements and those companies that don't.

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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

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STOP PRESS**ACSI writes to Australian Stock Exchange seeking superannuation industry representation on the Australian Stock Exchange Corporate Governance Council**

7 August 2002

Mr Richard Humphry
Managing Director & CEO
Australian Stock Exchange Limited
20 Bridge Street, Exchange Centre
SYDNEY NSW 2000

Dear Mr Humphry,

Corporate Governance Council

The Australian Council of Superannuation Investors ("ACSI") welcomes recent announcements by the Australian Stock Exchange ("ASX") to establish a Corporate Governance Council that will develop in consultation with the business community, corporate governance standards that will apply to ASX listed companies.

ACSI comprises of a number of Australia's largest superannuation funds (list attached) with over four million members, who have significant investments in companies listed on the ASX. ACSI is a not for profit organisation and was formed to assist superannuation trustee boards to make informed decisions on corporate governance issues.

The considerations of the ASX Council will directly impact on the levels of confidence of superannuation funds in investee companies listed on the ASX.

We are therefore concerned that your recent announcement made no reference to ongoing representation on the Council from the investors. We believe that in order to ensure that the Council's outcomes are recognised by key members of the investor community, then it is integral to have an investment community representation body, including participation from the superannuation industry.

We therefore would like to convey ACSI's interest in participating in the Council and the development of future standards.

Yours sincerely,

MICHAEL O'SULLIVAN
President



Director and Executive Share Options Granted by
Top 100 Companies during 2001:
Which Companies Disclosed the Options' Value?

Prepared for the Australian Council of Super Investors Inc. (ACSI)

Distribution: Strictly limited to ACSI and its members

August 2002

Published in Melbourne by



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S&P/ASX 100 Companies

2001 ANNUAL REPORTS

DISCLOSURE OF DIRECTOR AND EXECUTIVE OPTIONS GRANTED DURING THE FINANCIAL YEAR

Companies which disclosed	Companies which didn't disclose
Amcor	AXA Asia Pacific
AMP	BHP Billiton
ANZ	Billabong International
Aristocrat Leisure	Brambles
Bank of Western Australia	Cable & Wireless Optus [since taken over by Singapore Telecom]
Boral	Coca-Cola Amatil ^a
Brambles	Cochlear
BRL Hardy	Commonwealth Bank
Coles Myer	CSL
CSR	Harvey Norman
Futuris Corporation	Lang Corporation (now Patrick Corp)
Macquarie Bank	National Australia Bank
Mayne Nickless	National Foods
Newcrest Mining	Orica
News Corporation	PaperlinX
Origin Energy	QBE
Perpetual Trustees Australia	Sons of Gwalia
Santos ^b	Southcorp
Seven Network	TAB
Suncorp Metway	Tabcorp
Telstra	United Energy
Toll Holdings	Westfield Holdings
Transurban	Woolworths
Westpac	
WMC	

^a Coca-Cola Amatil disclosed the value of options as at date they were exercised (in essence, when they were converted into shares), rather than as at the date the options were granted. Also, this disclosure did not reveal which executives had exercised these options.

^b The Santos Annual Report discloses the value of options granted, but does not include the value in the table of directors' and 5 highest-paid executives' remuneration, for this reason: "These values have not been included in the emoluments disclosed above as they are only notional values and ultimately no benefit may accrue."

Notes

- The source of a disclosure requirement (if any) is section 300A of the Corporations Act. There is a debate as to whether or not section 300A mandates disclosure of the value of options granted to directors and the 5 highest-paid executives during the financial year.
- The total number of companies in the table is less than 100 because:
 - Some companies did not grant any options to directors / 5 highest-paid executives during the year.
 - Some companies do not have options plans – e.g. Fosters, which now grants shares (rather than options) to executives when the company performs well.
 - Listed property trusts (e.g. Westfield Trust) are not companies and therefore do not have shares and cannot issue options over shares.
 - Some Top 100 companies are not Australian companies (e.g. Telecom NZ, Lihir Gold) and therefore do not have to comply with the Australian Corporations Act disclosure requirements.
- Not all companies use the same valuation method. Black / Scholes is the most popular.

Examples of companies' reasons for not disclosing value of options granted

Commonwealth Bank Annual Report

If the performance hurdle is not met, the options will have nil value. Options issued during the year to executives under the Executive Option Plan have an exercise price equivalent to the Market Value of the Bank's ordinary shares as at the Commencement Date of the options. As the options are subject to a performance hurdle, the achievement of which is uncertain, the amount included as remuneration in the above table is nil.

Harvey Norman Annual Report

The eventual value of these options is indeterminable but will eventually depend upon the value the sharemarket places on the company's shares during the 24 months during which these options may be exercised. The sharemarket price will in turn depend upon the company's performance and, in part, on many other factors beyond the company's control such as general market conditions, interest rates, etc.

Orica Annual Report

Using the Black-Scholes Option Pricing Model, based on an exercise price of \$5.72 per share, a range of values of each option issued during the financial year can be calculated, applying reasonable ranges of probabilities of exercising the option and the expected volatility of the underlying share. In the opinion of the Directors, on the grounds that the options cannot be traded, and given the nature of the performance hurdles that have been established for these options, it is not appropriate to attribute a fair market value or range of fair market values prior to the performance hurdles being achieved.

Tabcorp Annual Report

The directors believe that, as the options cannot be traded and given the nature of the performance benchmarks, it is not feasible to apply a credible value, or range of values, to the options at this stage. This position will be reviewed annually and if a point is reached where a value can realistically be placed on the options, this will be done.