



# "CORPORATE CITIZENSHIP"

A NEWSLETTER OF  
THE AUSTRALIAN COUNCIL OF SUPERANNUATION INVESTORS

## GOVERNMENT RELEASES CLERP 9

The Federal Government recently released CLERP 9 (Corporations Law and Economic Reform Program). Its emphasis is to update Australian corporate regulatory provisions that apply to Australian corporations.

In summary the reforms proposed by the Federal Government include:

- Expanding the responsibilities of the Financial Reporting Council to oversee auditor independence. This will include monitoring the auditing profession on issues of independence and disclosure;
- Promoting audit independence by introducing the following measures:

- Requirement that auditors declare their independence and that audit committees sign off on the declaration;
- Restricting employment relationships between an auditor and audit client (including a two year restriction on ex-auditor partners becoming a director of the client);
- Applying international standards requiring auditors to identify and evaluate threats to independence through the provision of non-audit services (in particular with regard to preparing accounting records and financial statements of the audit client; valuation services; internal audit services; IT systems services; temporary staff assignments; litigation support services; legal services, recruitment of senior management for the audit client; and corporate finance and similar activities) ,
- Require annual report disclosure of fees paid for non-audit services apply and requiring all top 500 listed companies to have an audit committee;
- Making the rotation of audit partners compulsory after 5 years and requiring auditors to attend AGM of listed companies.

- Banning auditors and their families from investing in the companies in which they are examining
- Adoption of accounting standards of the International Accounting Standards Board on or after 1 January 2005.

Other CLERP 9 measures include:

- Requirement to expense share options in second half of 2003;
- Improved disclosure provisions requiring securities analysts to disclose financial interests that they or related party have on the subject of advice;
- Enhancement of continuous disclosure provisions of companies;
- Introduction of measures aimed at improving the quality of information to shareholders including the adoption of best practice guidelines in relation to notices of meetings from the ASX Corporate Governance Council. Improvements to explanations on bundled resolutions.
- Allowing shareholders to participate by electronic means of voting by removing some legal impediments

A number of CLERP 9 proposals have attracted some debate,

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particularly in relation to ensuring auditor independence.

Is it sufficient that auditors are able to continue to undertake non-audit work as long as the audit committee of a company can certify whether non-audit services compromises the auditor's independence? The government has rejected any proposal of disallowing audit firms from undertaking any non-audit work for the audited company, or at least prohibiting certain financial and legal services that may be provided by the auditor firm.

CLERP 9 has also avoided any consideration to separate investment research and analyst functions from the investing and banking services that may be provided by the same organisation. Instead, it will require that firms disclose any potential conflicts of interests that may be connected to the provision of advice. It has not however outlined in any detail as to what actually constitutes a "conflict of interest" in this regard.

CLERP 9 recognises the importance of shareholder activism and contains welcome proposals for improved shareholder participation including the introduction of improved disclosure requirements, the introduction of guidelines on notices of general meetings and amending existing laws to facilitate an electronic means of voting.

The Blair Government is introducing a series of Corporations Law reforms which among other proposed reforms also include the introduction of legislation requiring trustees and investment managers to become active on corporate governance issues through proxy voting or engagement, when there is a reasonable expectation that such action is likely to enhance the value of an investment.

Although there are general law requirements for Trustees to consider whether to exercise their proxy vote in Australia, there are no

comparable provisions that require Trustees to intervene in the companies in which they invest.

Copies of CLERP 9 are available on the Treasury's website on [www.treasury.gov.au](http://www.treasury.gov.au).

### **FEDERAL OPPOSITION RELEASED CORPORATE GOVERNANCE POLICY**

The Federal Opposition has also recently released its revised corporate governance policy. Outlined below is a summary of Labour's policy commitments that include:

- Doubling the penalties for serious breaches of the Corporations Act;
- Introducing legislation to protect corporate whistleblowers;
- Implementing the recommendations of Professor Ramsay and in addition, banning the provision of certain non-audit services to audit clients;
- Requiring auditors to specifically report to shareholders and to a company's audit committee on instances of aggressive accounting;
- Requiring auditors to attend and answer questions at annual general meetings;
- Requiring the full disclosure of arrangements governing executive remuneration and enforcing the requirements for disclosure in the *Corporations Act*;
- Expensing share options;
- Providing to all shareholders any information provided to analysts during an analyst briefing;

- Requiring shareholders to be given the following information about candidates for directorships:

- all relationships between the candidates and the company;
- any relationship between the candidate and the directors of the company; and
- any other directorships held by the candidate.

- Improve analysts' independence by ensuring that they always act in the interests of the users of the reports – not in the interest of the analyst or the firm which employs the analyst; and
- Requiring voting by trustees of superannuation funds supervised under the *Superannuation Industry (Supervision) Act* if the level of voting does not increase to levels comparable with overseas.

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### **ACSI JOINS AUSTRALIAN STOCK EXCHANGE CORPORATE GOVERNANCE COUNCIL**

The Australian Stock Exchange Corporate Governance Council has been recently formed to facilitate the development of best practice guidelines on a range of corporate governance standards and requirements, including the Listing Rules and guidance notes of the ASX together with looking into methods of shareholder participation in the governance process.

The ASX Corporate Governance Council, is comprised of representatives from diverse stakeholder organisations including members of the superannuation and investment community. ACSI will now join ASFA, AIST, IFSA and

the ASA in representing various investor interests in the development of appropriate guidelines.

ACSI representatives on the Council are Steve Gibbs (PSS/CSS), Elizabeth Bryan (UniSuper) and Lisa Fazio (HESTA). The Council will perform an important role in developing and implementing guidelines arising out of CLERP 9 and will be recommending best practices to support shareholder activism.

#### **Report from Steve Gibbs on ASX Corporate Governance Council meeting on 19 September 2002**

#### **CLERP 9**

There were a number of comments, which were positive about the CLERP 9 announcements and these concentrated on the announcements regarding the requirement for entities in the ASX500 to have audit committees, and the significant role, which CLERP 9 envisaged that the ASX CGC would play.

There were, however, a number of representatives who expressed opposition/reservation about specific CLERP 9 announcements. These included:

- Australian Institute of Company Directors (AICD) expressing concern that ASIC could fine companies and then companies would have to go to court to overturn the penalty (a view shared by IFSA)
- Disappointment that CLERP 9 did not include a requirement for CEO/CFO 'certification' of accounts
- Disappointment that CLERP 9 did not include more about the MD+A analysis

There appeared to be an inclination by some to have the ASX CGC

endorse the CLERP 9 announcements, however, the majority view (which was the Investor Group's view) was that it was too early to be endorsing the announcements. In the end, the statement issued at the conclusion of the CGC meeting noted a couple of the positive aspects of CLERP 9 (see later).

#### *Separate corporate governance filings*

The ASX proposed that companies be required to disclose where they do not follow the best practice recommendations of the CGC and to explain why. There was broad support for this proposal. It was suggested that each company should be required to expressly state that 'except as detailed below the company complies with the best practice recommendations of the ASX CGC', although it was unclear whether the form of such a statement was agreed.

There was debate on whether the required statement should be disclosed within the annual report or via a separate filing. This debate was inconclusive although the final ASX statement after the meeting seems to imply that the statement would be in the annual report.

#### *Remuneration*

A very general discussion took place noting the work done by AICP. IFSA on behalf of the Investor Group raised the issue that a statement should be made by the CGC reminding companies that there were existing guidelines on corporate governance (including executive and board remuneration) and calling on companies, in the current reporting season, to abide by those guidelines. This was agreed although the final statement was not as clear or as strong as it could have been (again, see later).

#### *Analyst independence*

A lengthy discussion took place on analyst independence. The ASX is proposing to issue a Business Rule Guidance Note on this matter, which would establish minimum requirements. The ASX requested the CGC endorse the issuing of the proposed rule for comment. This was resisted by the Securities Institute of Australia (SIA) and the Securities and Derivatives Industry Association (SDIA) on the basis that there were existing best practice guidelines which were considerably better than the proposed minimums.

My observation here is that having good best practice guidelines is admirable but if few are following them then perhaps some minimum enforceable standards are necessary. This particular debate will be worth following.

#### **WORK PROGRAM**

The CGC agreed to establish working groups. There was some initial reticence from the Investor Group about the establishment of working groups (myself included) although it was decided that from a practical point of view there was really no alternative. The Investor Group is represented on each working group.

The working groups with the Investor Group representation noted are as follows:

- Board composition and independence of directors - AIST, IFSA;
- Competency of directors - ASFA;
- Remuneration (i.e. executive and directors) - ACSI, ASA & IFSA;
- Related party transactions - IFSA;

- Financial reporting (audit committees, auditors, management accountability) – ACSI;
- Risk management and code of ethics for senior staff – ASFA;
- Shareholder participation – ASA, IFSA.

## CORPORATE GOVERNANCE IN AUSTRALIA - A REVIEW OF THE LAST YEAR... RETRACING OLD FOOTSTEPS

*Article: Mr Sam Kovacevic (Currently completing a PhD at Monash University on Remuneration Practices in Corporate Australia.*

Given the recent and highly prominent failures of Australian businesses such as HIH, One.Tel, Harris Scarfe, and Ansett, it is not surprising that corporate governance issues would once again come to the fore in the business press. Following ACSI's "Corporate Governance & Trustees" conference held in Melbourne earlier this year, this short article is a timely re-cap of some of the key developments in the recent history of Australian corporate governance.

One of the key issues in the Australian corporate governance debate is the need to strike a balance between the strict adherence to (potentially narrow) corporate laws and sound commercial practices. The issue is raised a number of times in Fred Hilmer's *Strictly Boardroom*, and, more recently, by leading businessman Stan Wallis. Wallis believes that the pursuit of good practice would often be at the expense of good performance, which would negatively impact on shareholder returns. Similarly, the former CEO of the Australian Institute of Company Directors (AICD) Ian Dunlop and David Knott, chairman of the Australian

Securities and Investments Commission (ASIC), have debated the value of strict adherence to rigid governance guidelines. Dunlop attributes part of Australia's "success" in avoiding the Asian economic crisis of the late 1990s to sound governance, while Knott asserts that best practice does not necessarily equate to a vaccine against corporate failure:

The best governed of companies can still succumb to competitive and economic forces. Good governance is of itself no assurance of corporate success, any more than corporate failure necessarily implies poor standards of governance.

In the early 1990s, Henry Bosch's Working Party on Corporate Practices and Conduct sought to provide guidelines that would improve the standards of corporate governance in Australian companies, and reduce the need for more detailed legislation. *Corporate Practices and Conduct* advocated increased responsibilities for non-executive directors, and more prominent roles for board committees such as the audit and remuneration committees. However, the first edition of *Corporate Practices and Conduct* stopped short of recommending compliance to become a part of Australian Stock Exchange (ASX) listing requirements. The book was revised twice (1993 and 1995) in the light of subsequent court decisions, the growing influence of institutional investors, and the proliferation of new corporate governance codes and statements in both Australia and other countries.

In 1992, the Sydney Institute established the Independent Working Party into Corporate Governance, chaired by Professor Fred Hilmer. The committee released *Strictly Boardroom: Improving Governance to Enhance Company Performance* in 1993. Again, this discussion was averse to

promoting any practices that could stifle entrepreneurship for the sake of complying with legal minima. The "main game" of wealth creation (the driver of new investment and job creation) is not forgotten in many of the *Strictly Boardroom* recommendations.

A number of concerns underpin Hilmer's book. First, his committee was sceptical that regulation would counter the effects of economic booms and busts. Regulation that would divert attention from creating shareholder value was to be avoided. Second, adding to the body of corporate law already in existence was not seen as appropriate for addressing corporate failures. Third, corporate law was seen to be punctuated with politically-driven responses to specific frauds and collapses from the past (note Peter Costello's recent "CLERP 9" proposals). Such laws could become redundant, but would still incur compliance costs. Finally, a better understanding of the responsibilities and functions of company officers was required before legislation was enacted to regulate their behaviour.

The Investment and Financial Services Association (IFSA, formerly the Australian Investment Managers Association, or AIMA) also took an active role in promulgating best practice corporate governance in the 1990s. Coupled with rising levels of share ownership, the increased role of the superannuation funds commanded greater attention from listed companies. Active in issuing a number of guidelines throughout the 1990s, IFSA produced the comprehensive *Corporate Governance: A Guide for Investment Managers and Corporations* (also known as *Guidance Note No. 2.00*) in July 1999. The majority of the recommendations in the *Guidance Note* related to issues such as disclosure, board and board committee composition, the roles and responsibilities of non-

executive directors, board and executive remuneration policy and disclosure.

Drawing primarily from Bosch's *Corporate Practices and Conduct* and IFSA's corporate governance *Guidance Note*, the ASX issued *Guidance Note 9*, a commentary on *Disclosure of Corporate Governance Practices: Listing Rule 4.10*, in September 2001. Listing rule 4.10.3 requires a company's annual report to disclose main corporate governance practices for the reporting period. Essentially, the listing rule is no more prescriptive than the requirement of a general statement of corporate governance practices, but *Guidance Note 9* does include an indicative list of governance matters that a listed organisation may take into account when satisfying rule 4.10.3.

A number of other organisations have made contributions to the Australian corporate governance debate. The AICD has released guidelines primarily aimed at its constituents, as well as regular policy discussion papers. The Australian Shareholders' Association (ASA) has experienced a significant growth in prominence with the privatisation of publicly-held utilities, and has also managed to have a greater voice in annual general meetings. The ASA has also published a number of position papers on a broad range of topics including donations to political parties, audit independence, executive options, and some accounting issues. The Federal Treasury has also entered the governance discussion at times, and politicians have often taken firm positions against what was generally perceived to be 'bad practice' in the corporate sector.

Finding a balance between self-regulation and government intervention into most, if not all, facets of corporate decision-making will be difficult. Neither extreme guarantees against corporate failures or dysfunctional behaviour, but both

seek to at least minimise adverse effects on shareholder returns. For now, continually questioning proposed reforms and contributing to the corporate governance debate will perhaps be of greatest benefit to investors and trustees. Documents such as ACSI's *Corporate Governance Policy Options for Trustees*, for example, can constructively contribute to the debate, but cannot promise to be the answer for all of Australia's corporate ills. In this case, 'common sense' may be what all participants are ultimately aiming for, as what constitutes 'good corporate governance' still remains problematic.

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