



Guidance Note 9

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Key topics

1. Corporate governance
 - generally
 - indicative list
2. Annual report disclosure
3. Directors
 - appointment
 - non-executive directors
 - remuneration
 - the Chair
4. Audit
5. Business risks

Listing Rules

1. Listing rule 4.10

Guidance Note History

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Disclosure of Corporate Governance Practices: Listing Rule 4.10

Introduction

1. This Guidance Note is published to assist listed entities in the preparation of the statement of corporate governance practices an entity must give Australian Stock Exchange Limited (ASX) under listing rule 4.10.3.
2. Listing rule 4.10 states:

An entity must include the following information in its ⁺annual report. The information must be current at a date specified by the entity which is no more than 6 weeks before the report is sent to ⁺security holders.

...

4.10.3 A statement of the main corporate governance practices that the entity had in place during the reporting period. If a practice had been in place for only part of the period, the entity must state the period during which it had been in place.

The role of ASX

3. The role of ASX in the area of corporate governance is primarily to promote the disclosure of corporate governance practices adopted by listed entities and to assist in the development of these practices generally. ASX policy is not to require that particular practices be adopted or that entities report against prescribed check-lists (a 'tick the box' approach).

4. Given the diversity of entities that ASX lists, the existence of alternative solutions to address particular governance problems and the development of corporate governance ideas over time, the emphasis is on appropriate disclosure of practices in place at the time an entity reports.
5. Entities are encouraged to consult corporate governance guides to best practice when assessing the appropriateness of particular practices and the time frames in which they might be adopted. ASX recognises that some entities (in particular, smaller listed entities) may have difficulty in adopting some of the recommendations made in the guides. For example, recommendations that there be a sufficient number of non-executive directors to ensure a strong element which is independent of management on the board and to participate on the various board committees may not be possible to implement, on grounds of cost. Each entity should make its own assessment of the practices appropriate to its particular circumstances.
6. There are a number of general guides to best practice developed in the Australian market. Two readily available guides are the following.
 - ‘Corporate Practices and Conduct’ (November 1995) issued by the Working Group on Corporate Practices and Conduct (the ‘Bosch Committee’). The Group comprised the Australian Institute of Company Directors, the Business Council of Australia, the Australian Society of CPAs, the Law Council (Business Law Section), the Institute of Chartered Accountants in Australia and the Securities Institute of Australia.
 - ‘Corporate Governance: A Guide for Investment Managers and Corporations’ (July 1997) issued by the Australian Investment Managers’ Association (AIMA).

The Australian Institute of Company Directors (AICD) has also published a series of corporate governance papers including a guide on director remuneration.

Disclosure in annual reports

7. For the purposes of listing rule 4.10.3, most listed entities include a separate section in their annual report detailing the main governance practices that they have had in place. Others incorporate the statement in an ‘other statutory information’ section or the directors’ report. ASX encourages the former approach of a separate section.
8. AIMA in its guidelines recommends as follows:

The board of directors of a listed [entity] should prominently and clearly disclose, in a separate section of its annual report, its approach to corporate governance. This should include an analysis of the corporate governance issues specific to the [entity] so that public investors understand how the [entity] deals with those issues.

There is widespread acceptance of this view.

Corporate governance matters generally

9. The governance of a listed entity rests to a large extent with its board of directors. For this reason, many statements of best practice in corporate governance concentrate on the structure boards should adopt and how they might perform their functions more effectively. Current practice and corporate governance guides suggest that, together with other specific information relevant to the entity, the following governance matters will be considered.
- The appropriate mix of executive and non-executive directors.
 - The independence of non-executive directors.
 - The oversight of the preparation of the entity's financial statements, internal controls, and the independence of the entity's auditors.
 - The review of the compensation arrangements for the chief executive officer and other senior executives.
 - The way in which individuals are nominated for positions on the board.
 - The resources that are made available to directors in carrying out their duties.
10. An entity may establish board committees to examine various issues and make recommendations to the board. These committees can serve to implement and support the function of a board in overseeing the management of an entity. Because of their smaller size, they are often able to consider matters more effectively than a full board. Moreover, they can help to ensure that there is a greater involvement of non-executive directors regarding matters in which executive directors might face conflicts of interest (for example, the remuneration of senior executives, the selection of board members, the audit of financial statements). There are three main types of board committees - the audit committee, the remuneration (or compensation) committee, and the nomination committee.

Indicative list of corporate governance matters

11. Attached to this Guidance Note is an indicative list of corporate governance matters (formerly Appendix 4A Listing Rules, removed 30 September 2001. It is not intended to represent a guide to best practice. Rather, its purpose is to identify various matters that an entity may consider when preparing its statement for the purposes of listing rule 4.10.3. Each of these matters as they relate to entities are expanded upon below to further aid entities in preparing corporate governance statements.

The aim of the discussion is not to prescribe particular practices by indirect means, but rather to identify various issues and to provide further insights concerning matters which listed entities usually will need to consider in preparing their disclosure statements.

Board composition

12. Items 1 to 3 of ASX's indicative list of corporate governance matters relate to the composition of an entity's board:

...whether individual directors, including the Chair, are executive or non-executive directors...

The main procedures the entity has in place for:

- *devising criteria for membership of the [board];*
- *reviewing the membership of [the board]; and*
- *nominating representatives to [the board].*
- *...*

The policies relating to the appointment and retirement of non-executive directors...

These matters raise complex issues for entities both in terms of deciding what approach is appropriate for their circumstances and what to disclose under listing rule 4.10.3. The discussion below is designed to assist in both regards.

The role of non-executive directors

13. There is considerable support in the business and investment communities for the role that non-executive directors can play in the development of an entity. Non-executive directors are frequently said to serve a variety of roles including monitoring senior managers and executive directors and developing business strategies. There is also a commonly held view that their effectiveness in the monitoring role will be enhanced if they are independent of the entity and its management (other than, of course, in respect of their positions on the board). This is not to suggest that directors who are not 'independent' do not act in accordance with their common law and statutory duties.
14. There are a number of descriptions of 'independence'. The description in the AIMA guidelines draws upon other recent statements of best practice and could serve as a useful means of categorising directors in annual reports. The AIMA says that an independent director is one who meets each of the following criteria.
- The director is not a member of management.
 - The director is not a substantial shareholder of the entity or an officer of or otherwise associated directly or indirectly with a substantial shareholder of the entity.
 - The director has not within the last three years been employed in an executive capacity by the entity or another group member or been a director after ceasing to hold any such employment.
 - The director is not a principal of a professional adviser to the entity or another group member.

- The director is not a significant supplier or customer of the entity or another group member, or an officer of, or otherwise associated directly or indirectly with a significant supplier or customer.
 - The director has no significant contractual relationship with the entity or another group member other than as a director of the entity.
 - The director is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the entity.
15. There is widespread acknowledgment that smaller entities may have difficulty in appointing a majority of non-executive or independent directors. There have been views expressed that where smaller entities are considering the appointment of non-executive directors, the individuals selected should be independent and not merely non-executives.

The Chair

16. The chair of a board of directors plays a crucial role in ensuring that the board works effectively. There have been some suggestions that it is desirable for the chair to be someone who is not a current or past executive of the entity to avoid potential conflicts of interest in management matters. While guides to best practice generally express a strong preference for the roles of chair and chief executive to be separated, they usually suggest that this concern could also be mitigated by a 'strong independent influence on the board'.
17. Worldwide, differing approaches have been suggested. The Cadbury Committee (1992) in the United Kingdom recommended that the independent element on the board should have a recognised senior member (or lead director). Similarly, in Australia the Bosch Committee guide suggests that where the roles of chief executive and chair are combined, the appointment of a lead independent director should be considered. The AIMA guide suggests that if the chair is not an independent director, the independent directors should elect one of their number to be lead director. Another approach discussed by a committee established by the Toronto Stock Exchange in 1994 (the TSE Committee) is the establishment of a governance committee of non-executive directors which has the responsibility for administering the board's relationship to management.

Appointment of directors

18. Procedures for the appointment of directors often vary between entities and may involve either consideration by the whole board or a more detailed selection process involving, for example, consideration by a nomination committee or non-executive directors only. Many entities, as part of this process, engage specialist external consultants.

19. If an entity has a nomination committee it is normally considered best practice to set out, or summarise, the committee's main responsibilities, the names of committee members and any positions in the entity (for example, director of the entity). It may be argued that this information can, in some circumstances, indicate the likely effectiveness of the committees. A number of best practice guides suggest that ideally a nomination committee should comprise a majority of non-executive directors (preferably independent directors), including a chair who is independent.
20. Entities often provide additional details concerning the appointment of directors including, amongst other things, the following information.
- Whether the entity provides potential candidates for the position of non-executive director with a letter of appointment setting out such matters as directors' responsibilities and rights (it is becoming increasingly common for entities to provide such letters).
 - Whether there is a retirement age for directors.
 - Whether there is a maximum fixed term (assuming re-election) for non-executive directors.
 - Whether the entity has established internal performance reviews of directors offering themselves for re-election.

Other disclosures

21. Entities often include additional details about board composition in their corporate governance statements including the matters set out below.
- Age of each director.
 - Qualifications and experience of directors.
 - Whether directors act as nominees or representatives of particular shareholders.
 - Those directors who are non-executives and those who are 'independent' (discussed above).
 - Information on directorships of other public entities.

Resources available to directors

22. Item 4 of ASX's indicative list of corporate governance matters relates to independent advice available to directors:

The main procedures by which the [board] or individual [directors] can seek independent professional advice, at the entity's expense, in carrying out their duties.

23. It is generally accepted that individual directors will function more effectively if they have reasonable access to professional advice that is independent of entity management and available at the entity's expense. One instance where a director may want to obtain such advice is where the director believes that the board is making a wrong decision. An unfettered right to such advice, however, may give rise to abuse. Controls that reduce the likelihood of such abuse might include making the appointment of an independent professional adviser conditional upon the approval of an appropriate board committee or the chair, if the chair is a non-executive director.
24. The extent to which directors should be able to obtain independent legal advice at the entity's expense has been considered in overseas jurisdictions. The Cadbury Committee recommended that directors should be able to obtain advice that is necessary in performing their duties through a formalised procedure. This should be, for example, contained in a board resolution, in the articles of association, or in the letter of appointment. The TSE Committee (1994) recommended that the board of directors should implement a system which enables an individual director to engage an outside adviser at the expense of the entity in appropriate circumstances, and the engagement should be subject to the approval of an appropriate committee of the board.

Compensation arrangements

25. Item 5 of ASX's indicative list of corporate governance matters relates to the compensation of directors and executives:

...the main procedures for establishing and reviewing the compensation arrangements for:

- *the chief executive officer (or equivalent), and other senior executives of the entity, and*
- *non-executive members of the [board]...*

26. In many cases this procedure involves a remuneration committee. If a remuneration committee is in existence it is normally considered best practice that entities set out, or summarise, the committee's main responsibilities, the names of committee members and their positions in relation to the entity. A number of guides to best practice suggest that it is appropriate to have a similar structure to that of a nomination committee - comprising a majority of non-executive directors (preferably independent directors), including a chairperson who is independent.
27. The AICD guide on remuneration matters recommends that 'each [entity] board should have a clear written statement of remuneration policy and procedure, the general terms of which are disclosed in the annual report or a separate report to shareholders'. The AIMA guidelines contain a format for remuneration disclosure. The AIMA has also published guidelines on executive share option schemes.

28. Some entities include additional details on remuneration matters in their corporate governance statements including the matters set out below.
- The entity's remuneration policy for non-executive directors.
 - Whether retirement benefits are offered to non-executive directors.
 - Whether the entity has a policy on trading of shares in the entity by directors.

Audit matters

29. Item 7 of ASX's indicative list of corporate governance matters relates to the audit function:

The main procedures the entity has in place for the nomination of external auditors, and for reviewing the adequacy of existing external audit arrangements (particularly the scope and quality of the audit)...

30. In many cases the procedures will involve an audit committee. For example, all but a handful of the top 150 listed entities in Australia have an audit committee. If an audit committee is in existence it is normally considered best practice that entities set out, or summarise, the committee's main responsibilities, the names of committee members and their positions in relation to the entity.
31. It is considered best practice for an entity with an audit committee to state its policy regarding the committee's composition. Furthermore, there is considerable support in guides to best practice for the proposition that audit committees should be comprised of a majority of non-executive directors (preferably independent directors), including an independent chair (who is preferably not chairman of the board). Where executives participate in audit committee discussions, it is normally considered appropriate that, at a minimum, non-executive directors on the committee should have an opportunity to discuss matters with the auditors in the absence of members of management.
32. Listing rule 4.10.2 requires entities without audit committees to explain why a committee has not been put in place. An explanation commonly provided by smaller entities is that a committee cannot be justified on the basis of a cost-benefit analysis. Some entities have gone beyond the requirements of this listing rule and have provided explanations as to why certain other practices are considered inappropriate for that entity.
33. In 1997 the Australian Accounting Research Foundation, the AICD and the Institute of Internal Auditors jointly released a best practice guide entitled 'Audit Committees'. This includes a discussion of an audit committee's objectives and responsibilities.

Business risk

34. Item 8 of ASX's indicative list of corporate governance matters relates to business risk:

The [board's] approach to identifying areas of significant business risk, and to putting arrangements in place to manage them.

35. There has been considerable development over the last few years in the area of risk management, with the result that in some entities there are entire risk management departments. Risk management can be described as the application of management policies, procedures and practices to identifying, analysing, assessing, prioritising, treating and monitoring risk.
36. Guidance on risk management generally has been provided by Standards Australia in a standard entitled 'Risk Management' AS/NZS 4360 (1995).

Ethics

37. Item 9 of ASX's indicative list of corporate governance matters relates to ethical standards:

The entity's policy on the establishment and maintenance of appropriate ethical standards.

38. It is becoming more commonplace for entities to operate according to a code of ethics or conduct. Such codes are essentially statements of values and can offer the following benefits.
- Building the reputation of the entity for fair and reasonable conduct.
 - Helping to preserve high standards of conduct throughout the entity and developing a sense of pride amongst employees.
39. Some entities provide a statement in their annual report on the policy they have for the establishment and maintenance of appropriate ethical standards, including whether a code of ethics or conduct has been established. In this context, the AICD has published a code of conduct for directors.

Guidelines for securities trading and trading windows

40. Item 10 of ASX's indicative list of corporate governance matters relates to guidelines for securities trading and trading windows.

The entity's policy on the trading of its securities by directors and employees, including the use of trading windows.

41. The intention is only that if an entity has established guidelines in relation to securities trading for directors and employees, or if trading windows apply, that these be disclosed. Investors will have a better understanding of the factors affecting liquidity in a security if they are aware of the periods in which trading by directors and employees is likely to occur.

Application to unit trusts

42. The different structure of a trust, which has a single responsible entity, rather than a board of directors, means that the application of corporate governance practices needs to be adapted. In reporting under listing rule 4.10.3, trusts may report the corporate governance practices of the responsible entity, in which case the above discussion about entities is of assistance, for example, in relation to reporting on board composition. Reporting on the corporate governance practices of the responsible entity is an increasingly common practice for trusts. Alternatively a trust may report the main factors governing the relationship between the trust and the responsible entity (for example, the basis of the appointment and the basis upon which fees are paid).
43. The Corporations Act regime for managed investment schemes, introduced on 1 July 1998, affects the corporate governance practices of listed trusts that are or become managed investment schemes. Under that regime, unless at least half of the directors of the responsible entity are external directors (as defined in section 601JA), the responsible entity must establish a compliance committee. The compliance committee must have a majority of external members (as defined in section 601JB).
44. The functions of the compliance committee include monitoring compliance by the responsible entity with the scheme's compliance plan. The compliance plan sets out the measures the responsible entity is to apply in operating the scheme to ensure compliance with the Corporations Act and scheme's constitution. If a responsible entity does not have a compliance committee, consideration should be given to outlining how the responsible entity addresses the matters otherwise dealt with by the compliance committee.

ATTACHMENT

List of Corporate Governance Matters

The following is an indicative list of corporate governance matters that an entity may take into account when making the statement in its annual report under rule 4.10.3.

1. If the entity is a body corporate, whether individual directors, including the Chair, are executive or non-executive directors (in the case of a trust, whether individual directors of the responsible entity or management entity, including the Chair, are executive or non-executive directors and whether they are external or non-external directors).
2. The main procedures the entity has in place for:
 - devising criteria for membership of the entity's governing body;
 - reviewing the membership of that body; and
 - nominating representatives to that body.

If a procedure involves a nomination committee, set out, or summarise, the committee's main responsibilities, the names of committee members and their positions in relation to the entity (eg, director of the entity).

Example: If the entity is a company the governing body is its board of directors. In the case of a trust, the governing body is the responsible entity, rather than its officers.

3. The policies relating to the appointment and retirement of non-executive directors (in the case of a trust, non-executive directors of the responsible entity).
4. The main procedures by which the governing body or individual members of it can seek independent professional advice, at the entity's expense, in carrying out their duties.
5. If the entity is a body corporate, the main procedures for establishing and reviewing the compensation arrangements for:
 - the chief executive officer (or equivalent), and other senior executives of the governing body, and
 - non-executive members of the governing body.

If a procedure involves a remuneration committee, set out, or summarise, the committee's main responsibilities and rights, and the names of committee members. If a member of the committee is not a member of the entity's governing body (eg, director of the entity), state that person's position.

6. If the entity is a trust, the main procedures for establishing and reviewing the compensation arrangements for the governing body.

If a procedure involves a remuneration committee, set out, or summarise, the committee's main responsibilities and rights, and the names of committee members. If a member of the committee is not a member of the entity's governing body (eg, a director of the responsible entity), state that person's position.

Example: If the entity is a company the governing body is its board of directors. In the case of a trust, the governing body is the responsible entity, rather than its officers.

7. The main procedures the entity has in place for the nomination of external auditors, and for reviewing the adequacy of existing external audit arrangements (particularly the scope and quality of the audit).

If a procedure involves an audit committee, set out, or summarise, the committee's main responsibilities and rights, and the names of committee members. If a member of the committee is not a member of the entity's governing body (eg, director of the entity), state that person's position.

Cross reference: rule 4.10.2.

8. The governing body's approach to identifying areas of significant business risk, and to putting arrangements in place to manage them.
9. The entity's policy on the establishment and maintenance of appropriate ethical standards.
10. The entity's policy on the trading of its securities by directors and employees, including the use of trading windows.