

## CONSISTENCY OF AUSTRALIA'S CORPORATE GOVERNANCE FRAMEWORK WITH OECD DRAFT PRINCIPLES

**Disclosure Standard: The corporate governance framework should ensure that timely and accurate information is disclosed on all material matters regarding the financial situation, performance, ownership and governance of companies (OECD Draft Corporate Governance Principles).**

In April 1998, the Organisation for Economic Co-operation and Development (OECD) called for the development of a set of international standards and guidelines on corporate governance to be considered at their May 1999 Ministerial Council meeting. To this end, the OECD established the Ad Hoc Task Force on Corporate Governance to develop a set of guidelines. The proposed Guidelines are intended to be a non-binding statement of common elements which member countries consider underlie good corporate governance.

It is envisaged that the Guidelines will assist member countries to evaluate and improve the legal, institutional and regulatory framework for corporate governance and also act as useful guidance for stock exchanges and corporations. Australia is involved in the development of the Guidelines at both the public and private sector level.

This attachment focuses on the disclosure principles of the draft guidelines.

***Disclosure Principle: Disclosure should include, but not be limited to, material information on:***

- 1. The financial and operating results of the company;***
- 2. Company objectives;***
- 3. Governance structures and policies;***
- 4. Major share ownership and voting rights;***
- 5. Members of the board and key executives, and their remuneration;***

*6. Material foreseeable risk factors; and*

*7. Material issues regarding employees and other stakeholders.*

## The financial and operating results of the company

Corporate managers have a legal obligation to record and make public disclosure of information about the corporation's business affairs. Proper financial record keeping and public disclosure of financial information are normally justified as the price to be paid for limited liability. It is considered that mandatory disclosure is essential in the interests of both market efficiency and investor protection.

In Australia, compulsory disclosure and financial reporting requirements have evolved both through the Corporations Law and through Australian Stock Exchange (ASX) Listing Rules.

The basic financial reporting requirements of companies under the Corporations Law are to:

- maintain financial records;
- prepare annual financial statements and a directors' report; and
- prepare a half-yearly financial statement.

Companies are required to maintain records which accurately record their financial transactions and which would enable the preparation of financial statements and the audit of those financial statements.

- The matters to be disclosed in the financial statements are contained in accounting standards, which are made by the Australian Accounting Standards Board and which have the force of law under the Corporations Law (see separate section on accounting standards).
  - The financial reporting requirements and accounting standards must be complied with - directors do not have a discretion whether or not to comply, and breaches are enforced by the Australian Securities and Investments Commission (ASIC).

Listed companies must also meet similar financial reporting requirements imposed by the ASX.

## Company objectives

The Corporations Law does not require a company to have specific objectives or that objectives be set out in a company's constitution or other publicly available document. In Australia a company's capacity to act is equated with that of a natural person — its capacity is generally not limited by a statement of objectives. A company may set out its objectives in its constitution or other documentation if it wishes, for example in the annual directors' report.

The directors' report (see following items, 'Governance structures and policies' and 'Material foreseeable risk factors') is required to include a review of the company's operations, results, and principal activities during the accounting period. If there are circumstances that may affect the company's future, the report is required to refer to likely developments in the company's operations in future financial years and the expected results of those operations.

## Governance structures and policies

The Corporations Law sets out detailed requirements for directors' reports. The types of information that should be incorporated in the reports include:

- a review of the company's operations and results during the accounting period;
- the company's principal activities during the accounting period;
- the net amount of the company's profit or loss during the accounting period;
- a statement of dividends paid or recommended;
- directors' contractual benefits; and
- indemnities given by the company.

In addition to the above Corporations Law requirements, ASX Listing Rule 4.10.3 requires each listed company to disclose in its annual report the main corporate governance practices it has had in place during the year.

The ASX decided not to adopt a prescriptive approach, such as requiring companies to adopt particular practices or report against a prescribed checklist of particular practices, as it was of the view that a less prescriptive approach would result in more information of greater relevance being released to the market. The ASX does, however, provide an indicative list of corporate governance matters that listed companies may wish to disclose in their annual reports. The ASX has released an updated guidance note on the disclosure of corporate governance practices.

The ASX has reviewed the operation of the rule and concluded, on the basis of a review of 791 company annual reports for reporting periods ending on or shortly after 30 June 1996, that:

- there has been a high level of compliance with the Listing Rule; and
- a large proportion of companies have committee structures in place to handle corporate governance issues.

The success of compliance with the requirements of the Listing Rule has not, however, been achieved without debate. In particular, the former Australian Investment Managers' Association (AIMA — now the Investment and Financial Services Association), representing institutional investors, considered that the Listing Rule did not go far enough and should require listed companies to indicate why they have not followed particular corporate governance practices identified in the checklist, along the lines of the requirements of the London Stock Exchange.

ASX listing rules also require listed companies to state in their annual report to shareholders whether they have an audit committee.

In June 1995, AIMA published a statement of 14 guidelines for recommended corporate practice by listed companies. The guidelines included recommendations that:

- there should be a majority of independent directors on the board of directors;
- the chairperson should be an independent director;
- committees of the board of directors should be constituted with a majority of non-executive directors;

- the board should appoint an audit committee, a nomination committee and a remuneration committee;
- non-executive directors should meet on their own at least once annually to review the performance of the board, the company and management and to discuss any other items raised by any of them;
- the board should establish a policy to encourage non-executive directors to own shares in the company;
- the board should at least annually review the allocation of the work of the company between the board and management;
- the board should annually review, and disclose in the annual report, its policies for remuneration, including incentives, of the board and senior executives. The justification for these policies and their relationship to the performance of the company should be similarly reviewed and disclosed. The quantum and components of the remuneration of each director and each of the five highest paid executives should clearly be disclosed in one section of the annual report. This should include the existence and length of any service contracts for the Chief Executive Officer;
- separate issues should not be combined and presented for a single vote by shareholders;
- major corporate changes which in substance or effect may erode share ownership rights should be submitted to a vote of shareholders; and
- every listed company should have a company code of ethics that is adopted by the board and all employees and is available to shareholders on request.

## **Major share ownership and voting rights**

Under the Corporations Law, the voting rights attaching to shares must be set out in the constitution of the company and, if the share forms part of an initial public offering, the rights must be set out in a prospectus.

A company's constitution may only be altered by a special resolution. However, this power is circumscribed under the Corporations Law and at common law which proscribes fraud on the minority.

Under the Corporations Law, every company is required to maintain a share register in which the names and addresses of the holders of its shares are recorded. A substantial shareholder of a listed public company must disclose its interest to the company within two business days after acquiring the interest and serve a copy of the notice on the ASX. A substantial shareholding occurs when a person is entitled to not less than 5 per cent of the relevant class of shares. The concept of 'entitlement' extends to associates and others who the person effectively 'controls'.

Upon reaching the 5 per cent limit, there is a continuing obligation to disclose any variations of 1 per cent or more in that entitlement within two business days. If these provisions are contravened, the court has a wide range of orders which it can make upon application of ASIC or the company.

In addition to the substantial shareholding notification requirements, the Corporations Law enables ASIC or the company to trace the beneficial ownership of that company's shares.

## **Members of the board and key executives, and their remuneration**

Under the Corporations Law, the names of all directors, both executive and non-executive, must be included in the annual report of the company. Any changes in directorships must be notified to ASIC and, in the case of public companies, also to the ASX.

Recent amendments were made to the Corporations Law to enhance disclosure of directors' remuneration, which must also be outlined in the annual reports of companies. In particular, companies are now required to:

- outline the broad policy for determining the nature and amount of remuneration of board members and senior executives of the company;
- outline the relationship between the policy and the company's performance; and

- provide details of the nature and amount of each element of the remuneration of each director and each of the five officers of the company receiving the highest remuneration.

Australian accounting standards also contain detailed requirements on how remuneration should be quantified and disclosed.

## Material foreseeable risk factors and material issues regarding employees and other stakeholders

Under the Corporations Law, the directors' report for a financial year, in addition to the matters listed above, must:

- give details of any matter or circumstance that has arisen since the end of the year that has significantly affected, *or may significantly affect*:
  - the company's operations in future financial years; or
  - the results of those operations in future financial years; or
  - the company's state of affairs in future financial years; and
- refer to likely developments in the company's operations in future financial years and the expected results of those operations.

In addition, if the company's operations are subject to any particular and significant environmental regulation under an Australian law, the directors must give details of the entity's performance in relation to environmental regulation.

Apart from the above, there is no specific requirement to report issues regarding employees and other stakeholders. However, in this regard it is noted that if such issues had, or potentially would have, a significant impact on the company's operations, they would need to be disclosed under the general disclosure requirements.

In addition to the annual report requirements contained in the Corporations Law, the ASX Listing Rules require listed companies to immediately disclose certain information to the market. In particular, Listing Rule 3.1 requires that:

3.1 Once an entity is, or becomes, aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information. This rule does not apply to particular information while each of the following applies:

3.1.1 A reasonable person would not expect the information to be disclosed.

3.1.2 The information is confidential.

3.1.3 One or more of the following apply:

- (a) It would be a breach of a law to disclose the information.
- (b) The information concerns an incomplete proposal or negotiation.
- (c) The information comprises matters of supposition or is insufficiently definite to warrant disclosure.
- (d) The information is generated for the internal management purposes of the entity.
- (e) The information is a trade secret.

The ASX may suspend an entity's securities from quotation or remove an entity from the official list if the entity does not comply with or breaks a listing rule, or if it is necessary to prevent a disorderly or uninformed market. The ASX may also grant a trading halt to a listed entity if information likely to affect the price or value of an entity's securities cannot be immediately released.

The Corporations Law reinforces the Listing Rule by creating criminal and civil penalties for breaches of it. If the ASX considers that a person has committed, or is about to commit a 'serious contravention' of the Listing Rules or the Corporations Law, it is under an obligation to lodge a statement with ASIC providing particulars of the matter.

More generally, where information is provided by a listed company to the ASX and the ASX makes that information available to the market, the ASX is under an obligation to provide that information to ASIC as soon as practicable.



***Disclosure Principle: Information should be prepared, audited and disclosed in accordance with high quality standards of financial disclosure, non-financial disclosure and audit.***

The Corporations Law contains detailed requirements regarding preparation and audit of information that is required to be disclosed. Independently set accounting and auditing standards must be used. A detailed description of the requirements in this area is contained in Attachments E and F dealing with accounting and auditing standards.

***Disclosure Principle: An annual audit should be conducted by an independent auditor in order to provide an external and objective control on the way in which financial statements have been prepared and presented.***

Both the Corporations Law and the ASX Listing Rules contain requirements on these matters. See Attachment F on auditing standards for a detailed explanation in this regard.

***Disclosure Principle: Channels for disseminating information should provide for fair, timely and cost efficient access to relevant information by users.***

The Corporations Law provides various mechanisms for shareholders, and the public, to obtain information about a company's affairs.

A shareholder has a statutory right to obtain a copy of the company's constitution. Shareholders also have a right to inspect minutes of general meetings and to obtain copies.

Companies are required to lodge copies of their constitution with ASIC and any amendments subsequently made to it. Similarly, documents affecting class rights must be lodged and shareholders have access to them.

Companies are also required to allow any person to inspect the register of members, the register of option holders and the register of debenture holders. A copy of a register must be provided within seven days of the request and upon payment of a fee.

Most information lodged with ASIC is available to the public which has the right to search non-confidential registers containing the following information:

- the constitution of the company;
- annual returns;
- return of directors, principal executive officer and secretaries;
- lists of members;
- returns of allotments of shares;
- statements of rights attached to shares where rights are not stated in the constitution;
- agreements that bind a class of shareholders;
- special resolutions;
- court orders approving a scheme of arrangement;
- removals or resignations of auditors;
- notices of appointment of a new trustee for debenture holders.

The public also has a statutory right of access to the following registers maintained by ASIC:

- company auditors;
- liquidators;
- company charges;
- disqualified company directors and officers;
- financial interests of members and staff of ASIC;
- licence-holders in the securities industry.

The Corporations Law requires companies/directors to send to members copies of the annual financial report, the directors' report and the auditors' report 21 days before the next annual general meeting after the end of the financial year or four months after the end of the financial year.

A meeting of members of a company or a class of members must, under the Corporations Law, be convened by notice in writing served on each member entitled to attend and vote at the meeting. At least 28 days' notice must be given of the meeting. A notice may be given by post, fax or electronic address (if any) nominated by the member or by any other means that the company's constitution permits.

As well as the above requirements, the continuous disclosure requirements referred to above ensure that shareholders and the market in general are informed about material matters affecting a company.