

A guide for superannuation trustees to monitor listed Australian companies



acsi
AUSTRALIAN COUNCIL
OF SUPER INVESTORS

ACSI Governance Guidelines May 2009

About ACSI

The Australian Council of Superannuation Investors (ACSI) provides independent research and advice to superannuation funds on the environmental, social and corporate governance risks of companies in which they invest.

ACSI members currently represent more than \$250 billion in funds under management and 57% of the Australian not for profit superannuation sector.

ACSI's overriding objective is to ensure that our members are equipped to deal with governance risks in their investments in a practical way.

To assist its members, ACSI provides the following services:

- Advise members on the governance practices of the companies.
- Provide proxy voting services to assist members to exercise their voting rights efficiently and effectively.
- Engage with companies to improve governance practices.
- Commission and produce research to support our policy positions.
- Publicly advocate for improved governance practices and standards including promotion of effective legislative and regulatory regimes.
- Develop good governance standards and practices that apply to public companies.

As a signatory to the United National Principles for Responsible Investment (UNPRI) ACSI:

- Encourages its members to become signatories to the UNPRI.
- Assists members with implementation of the UNPRI principles.

Further information about ACSI can be viewed at www.acsi.org.au including member and committee of management details, services and ACSI publications.

A new member joining the workforce today will expect to work for over 40 years. Over that time the risk and returns on her superannuation investments will be influenced by environmental, social and governance factors. Therefore it is imperative that superannuation funds manage these risks with a view to maximising shareholder value and increasing shareholder returns over the long-term.

Superannuation Funds and Company Governance

A significant proportion of superannuation funds' investments are held in domestic and international equities. Therefore, the success and long-term viability of publicly listed companies has a direct impact on the value of superannuation funds' investments and, ultimately, members' retirement income.

In discharging their fiduciary duties, a superannuation trustee is required to properly understand and assess likely material investment risks (and returns). In this regard, environmental and social risks have emerged as important investment considerations that are part of corporate governance risk.

As such:

- ACSI believes that 'good governance' requires boards to consider and manage all material risks facing the company, including environmental and social risks, in addition to traditional 'corporate governance' factors, and
- ACSI's members recognise that they can, and should, protect and manage their investments for the long-term through the consideration of environmental, social and corporate governance risks in their investment decision-making processes.

For these reasons, the Guidelines now include consideration of environmental and social risks. Accordingly, references to 'governance' in these Guidelines include corporate governance, environmental and social factors.

Actively monitoring governance practices provides another way for superannuation trustees to manage investment risks. ACSI believes that:

- Poor governance practices pose a threat to corporate performance, thus potentially destroying shareholder value and jeopardising members' financial interests.
- Effective governance structures and processes decrease risk and potentially increase returns because they create stability that assists the development of long-term investment strategies.
- Companies that best manage their governance risks, impacts and opportunities are more financially sustainable in the long-term and will deliver better long-term financial performance.
- Monitoring and addressing governance issues relevant to their investee companies is consistent with superannuation funds' objectives as long-term investors; and
- Incorporating governance considerations into investment decision-making will contribute to sustainable value creation.

Superannuation funds (as investors) need to be satisfied that the directors they elect to govern companies are focused on identifying and mitigating the risks and maximising the opportunities associated with material governance issues.

Although monitoring governance risks does not prevent corporate failure or collapse, it can reduce the risk of corporate failure and thereby potentially protect and enhance members' wealth in the long-term.

About these guidelines

ACSI first developed Corporate Governance Guidelines in March 2003 as a supplement to existing regulatory and industry standards. Since then, the Guidelines have been updated every two years to take into account the changing regulatory and governance landscape.

These Guidelines aim to provide companies with a clear statement of the practices that ACSI believes Australian companies should follow in conducting their business. The Guidelines reinforce the accountability of boards and management teams to shareholders.

The Guidelines also provide trustees of superannuation funds with a benchmark to assess the environmental, social and corporate governance practices of investee companies, in particular when exercising their voting rights. ACSI believes that super fund interests are best served by trustees who are properly equipped to address governance issues in their investments, without seeking to 'micro-manage' these issues in these companies.

Where superannuation funds are direct investors, ACSI believes that, they should make informed proxy voting decisions based on clear and transparent, best practice governance guidelines. ACSI acknowledges the contribution that both the ASX and IFSA have made to promoting improved governance practices through their respective guidelines. The ACSI guidelines however, were developed to reflect superannuation funds' expectations of the companies in which they invest.

ACSI members have had the opportunity to influence the development of the Guidelines. Accordingly, the Guidelines represent a strong collective statement by a significant group of Australian investors about their expectations of the companies in which they invest.

These Guidelines aim to strike a balance between the judicious use of shareholder powers to influence companies' affairs and avoiding an unduly rigid or prescriptive approach to governance issues.

These Guidelines have been developed principally for application in an Australian context, however, the underlying principles can have broader application in other jurisdictions.

These Guidelines are structured to highlight the key areas of consideration for ACSI and its members when looking at the environmental, social and corporate governance considerations for companies, namely, board responsibilities; board structure and processes; the relationship between the board; its executives and shareholders; disclosure and financial integrity.

In general, the reference made throughout this document to duties and responsibilities are focussed on 'boards' due to the collegiate and collective nature on which decisions are made.

ACSI will continue to review and update the Guidelines at least every two years.

ACSI publications can be viewed on www.acsi.org.au or hard copies can be requested by email at info@acsi.org.au.

About these guidelines

The Guidelines and ACSI's voting recommendations

These Guidelines underpin ACSI's Voting Alert Service recommendations and its engagement with Australian companies on behalf of its members.

ACSI does not approach governance with a 'one-size-fits-all' mindset, nor does it regard governance monitoring as a 'box ticking' exercise. Rather, ACSI takes a pragmatic and realistic approach which aims to consider the specific circumstances of the company. In particular, ACSI may take into account factors such as the materiality of the issue, the market capitalisation of the company, the length of time over which the shortcomings have occurred, whether the shortcomings are ongoing or historic, and the history of any dialogue between ACSI and the company on the particular issue when determining its voting recommendations.

ACSI will always seek to engage in constructive dialogue with a company and understand the position of a company board. Through this dialogue ACSI also seeks to promote improvements in how companies disclose relevant information and deal with material governance issues.

The Guidelines and engagement with companies

Broadly, there are three types of engagement activities that ACSI undertakes:

1. Engagement with individual S&P/ASX 200 companies.
2. Engagement at a sector or broader level regarding issues identified through research commissioned by ACSI.
3. Engagement with government, regulators and the broader investment industry to encourage mainstreaming of governance issues into investment decision-making processes.

For effective engagement, it is critical that companies properly disclose their performance in relation to material governance factors that could impact shareholder value. Effective disclosure by companies, in particular where a company goes beyond regulatory disclosure requirements, assists in raising investor confidence and confirming that boards are managing the governance risks and embracing opportunities that affect a company.

When engaging with companies, ACSI does not seek to be a 'de facto' or 'shadow' director of these companies, nor to 'micro manage' company operations. Rather the objective is to contribute to the long-term success of such companies on behalf of its members.

ACSI ensures that its dialogue with companies, industry bodies, regulators and other relevant stakeholders is conducted on a thoroughly researched and well informed basis and is always balanced and pragmatic.

With these considerations in mind, the Australian Council of Superannuation Investors (ACSI) is pleased to publish the fourth edition of its Governance Guidelines.

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Part A. Board responsibilities

1. Promoting good governance

- (a) Investors expect boards of directors ('boards') to formulate and apply high standards of governance behaviour.¹
- (b) A board should articulate the company's commitment to governance by developing a publicly disclosed charter or code on governance and ethics.²
- (c) Such a statement should confirm the company's commitment to complying with relevant Corporations Acts, regulations, Australian Stock Exchange (ASX) Listing Rules on corporate governance and generally accepted accounting practices and standards. The statement should also articulate the company's commitment to relevant environmental and social standards in business including relevant legislation, regulations, global standards and industry codes of practice. Accordingly, companies are encouraged to apply and report on how such a charter or code is applied at all levels of the company.
- (d) The board should establish a process to ensure that governance issues, especially governance risks are properly and regularly evaluated and managed by the company and that governance issues are fully considered and integrated into the company's business strategies.
- (e) The board should ensure that there are clearly defined board and senior management responsibilities for dealing with governance issues, both in the long and short term.
- (f) ACSI considers the constitution of a company as a significant governing document and, as such, any features or proposed changes should not diminish the rights of shareholders.

2. The board responsibilities

ACSI believes that rules and regulations alone are insufficient to instil high standards of corporate conduct and deliver the best protection to shareholders.

The essential ingredient of a sound governance culture within a company is an ethical, and competent board. Such a board should promote a healthy management culture throughout all levels across the organisation.

The 'glue' that binds any company or organisation to good governance is a strong ethical outlook from the board down and a commitment to promoting ongoing competence and accountability throughout the company. Companies need to develop and support cultures fostering accountability, commitment to shareholder value creation, business integrity, creativity, transparency, accountability and continuous disclosure.

Company directors must have the requisite skills, capacity, ethics and 'independence of mind' to provide effective leadership and stewardship of their companies.

2.1 General Oversight Responsibilities

- (a) The board must maintain oversight of the Chief Executive Officer (CEO) and take responsibility for the management and direction of a company. An integral responsibility of the board is to review, ratify and oversee the implementation of the company's business strategies.
- (b) When undertaking their responsibilities, the entire board and each individual member of the board must apply themselves in a manner that is consistent with their responsibility to the company and shareholders.

¹ References to 'governance' in these Guidelines are intended to refer to corporate governance, environmental and social factors.

² These Guidelines apply to companies and other types of listed entities including listed managed investment schemes and listed stapled securities.

Part A. Board responsibilities

- (c) Such a responsibility requires boards to:
- ensure that the company complies with all applicable laws
 - act in the best interests of the company, its shareholders and stakeholders
 - use their powers for proper purposes
 - not limit their discretionary powers, and
 - avoid actual and potential conflicts of interest.
- (d) When seeking to appoint a director who holds or has held positions with other companies, the board should consider the director's contribution to those other companies and their performance. Once a director is appointed, the board should also evaluate director performance on an ongoing basis.

2.2 Specific board responsibilities

- (a) The board is entrusted to oversee the company's business and to formulate, in conjunction with management, the company's policies and strategies. A board must therefore ensure it is adequately informed about key business issues and is properly equipped to encourage management to strive for above average performance in the company.
- (b) The board is regarded as an agent of shareholders, and is therefore responsible for governing a company. This responsibility cannot be delegated, however, key managerial functions can be, subject to the proper oversight of the board.
- (c) Some of the key responsibilities of a board include:
- exercising independent judgement over the company's business strategy, performance, resources and standard of conduct and ethics
 - the selection, appointment and performance management of the CEO and other principal senior executives
 - determining appropriate remuneration arrangements for the CEO and relevant executives
 - determining appropriate authorities of the CEO and relevant executives
 - developing, maintaining and approving CEO succession plans
 - properly reviewing the company's accounts and certifying that they comply with Australian accounting standards and represent a true and fair view of the affairs of the company
 - ensuring the maintenance of financial integrity, including the approval of budgets
 - articulating the companies commitment to environmental and social standards
 - establishing and reviewing key financial performance benchmarks
 - overseeing the company's system of internal control and disclosure
 - ensuring that proper accountability and systems are in place so that shareholders and stakeholders are informed in accordance with continuous disclosure obligations
 - ensuring that key developments are properly announced, and that prospectuses and reports to shareholders are produced in accordance with regulatory requirements
 - reviewing and assessing the board's and each individual director's performance. Section 14 provides further expectations of boards with regard to evaluation of board performance
 - undertaking the selection of nominees for election to the board
 - ensuring continuity of corporate learning, renewal, evolution and succession, and
 - ensuring all shareholders are equally informed of, or have access to the same information on the company's long-term prospects and plans.
- (d) The scope of the board's responsibilities should be documented in writing and shared with management of the company.

Part A. Board responsibilities

2.3 Familiarity and capacity to oversee corporate operations

- (a) Directors should ensure that they are independently familiar with the company's operations and do not rely exclusively on information provided to them by executive management and their advisers.
- (b) Each director should be able, and prepared, to devote sufficient time and effort to their duties as a director.
- (c) Boards should convey to prospective and current directors their general expectations about the workload associated with a directorship on the board.
- (d) Prospective or current directors should inform the board of their external commitments which may impact on their capacity to properly fulfil board responsibilities. This includes full and part-time employment or other directorships that they may hold for profit and not-for-profit organisations. In general terms, it would be prudent if a director did not hold more than four directorships in ASX-listed companies. However, it is recognised that a director's capacity to properly discharge their responsibilities will be assessed by investors on a 'case by case' basis.
- (e) The board, when appointing a director, will ultimately have due regard to the reasonable expectations and commercial interests of the company. It must determine whether a prospective or existing director is capable of discharging their duties to the company, in light of the other directorships he/she holds. This will involve such considerations as time constraints, work complexity and workload. In the context of risk management, a director's availability and capacity is particularly important, given the demands on directors in times of serious challenge or potential crisis for the company.
- (f) A CEO of an ASX-listed company may add value as a non-executive director of another listed company board. This can, subject to the CEO managing their primary responsibilities as CEO, enhance their understanding and insight into director duties and board responsibilities.

3. Risk management

- (a) ACSI regards risk oversight as a critical responsibility of the board. ACSI welcomes the establishment of risk management committees by a growing number of companies.
- (b) Board responsibilities in this regard include (but are not limited to):
 - establishing the company's policy on risk
 - overseeing the development and implementation of the company's system of risk management and internal control
 - monitoring the effectiveness of the risk management and internal control systems
 - making changes to the risk management and internal control systems as needed
 - ensuring there are clear lines of responsibility and accountability for risk management throughout the company
 - ensuring there is appropriate risk management oversight by the CEO and senior management
- (c) When establishing a company's policy on risks, boards should:
 - ensure there is an effective process to identify significant risks facing the company
 - consider all of the company's risks and potential liabilities, which include the company's financial, environmental, social and corporate governance risks (i.e. comprehensive enterprise risk management)
 - ensure there is an effective process for timely and comprehensive reporting by executives to the board and investors of significant risks facing the company
 - ensure effective disclosure to investors of a company's approach to mitigating material risk.
- (d) ACSI may make enquiries regarding the monitoring and oversight of environmental, social and corporate governance issues, risk management and internal controls.

Part B. Board structure and processes

4. Board structure

- (a) The board should be comprised of individuals:
- who are able to work together effectively to lead a viable, profitable and efficient company
 - with diverse backgrounds (e.g. age, gender, core expertise) who have a high degree of competency, integrity, skill, capacity, experience and commitment to discharge their duties and responsibilities.
- (b) There should be full disclosure by the company of each director's expertise and experience.
- (c) A board should be comprised of a sufficient number of directors capable as a group of fulfilling all board-related functions. The size of the board should be sufficient to ensure that there is an adequate number of skilled and independent non-executive directors on the board. According to ACSI research, the average board size of top 200 ASX companies for 2007 was eight.
- (d) A board should have in place a succession planning policy for sourcing new and replacing outgoing directors.
- (e) Board's should promote and support the role of independent and skilled non-executive directors who are engaged with the company and who can exercise independent judgement.

5. Independent non-executive directors

- (a) A board's capacity to effectively apply scrutiny over the activities of the company and its officers is directly affected by factors including the composition of the board and the extent to which it is comprised of a sufficient number of independent and skilled directors.
- (b) An independent non-executive director is expected to make decisions regarding the merits of the subject before the board, and not be affected by other extraneous considerations or influences.
- (c) Boards more effectively fulfil their supervisory and advisory functions by bringing an independent perspective to bear on issues. Independent non-executive directors perform a pivotal role in this regard. A person who is regarded as an independent non-executive director is expected to be able to make decisions in the best interests of the company in a manner that is independent of management and free of any business or other relationships that could materially interfere with, or could reasonably be perceived to materially interfere with, their judgement.
- (d) A board should be comprised of a majority of independent non-executive directors who are sufficiently motivated and equipped to fulfil the function of independent scrutiny of the company's activities.

Part B. Board structure and processes

5.1 Definition of independence

- (a) ACSI recognises that independence is determined predominantly by an individual's character and integrity. These cannot be objectively assessed by shareholders on a consistent basis and, therefore, written guidelines may not always be applicable or sufficient to address particular circumstances.
- (b) An independent non-executive director of a listed company generally should:
- not be a substantial shareholder of the company. In this context, 'substantial' is defined as a shareholding of 5% or more of the total number of votes attached to voting shares in the company as defined under the Corporations Act. This also includes an officer of a substantial shareholder of the company
 - not be a representative of a substantial or founding shareholder
 - not have been employed within the last three years in an executive capacity by the company or an associated entity of the company
 - not be or have been in the last three years a principal or employee of a professional adviser to the company or a related entity
 - not be a substantial supplier or customer of the company or related bodies corporate
 - not have a material contractual relationship with the company or related bodies corporate other than as a director of the company
 - be free from any interest or affiliation and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the independent non-executive director's ability to act in the best interests of the company
 - not participate in any share option or performance-related remuneration schemes that apply to executives within the company
 - not hold other directorships that potentially give rise to a conflict of interest or otherwise impede the proper discharge of their director responsibilities
 - not serve as a director or employee of a company in which the company has a notifiable holding³
 - not receive fees for services to the company at a level which is indicative of significant involvement in the company's affairs or which are significant in relation to fees received by directors
 - not serve as an executive director or employee of, or have a notifiable holding in, a significant competitor of the company
 - not be a spouse, de facto spouse, parent, child or a spouse or de facto spouse of other non-independent directors, senior executives or advisers to the company, and
 - not benefit from any related party transaction.
- (c) ACSI will consider on a case-by-case basis, whether the length of tenure of a director impacts on their independence.
- (d) In circumstances where the independent status of a director is altered, shareholders and the market should be notified of this changed position.

³ Shareholding of 5% or more.

Part B. Board structure and processes

6. Substantial or founding shareholders

- (a) Substantial or founding shareholders, who are either members of a board or nominate specific persons as directors, may perform an important role in the oversight of a company and can make important contributions to companies. Whilst recognising their position, it is important that a board outlines the checks and balances in place to ensure that all shareholder interests are properly taken into account.
- (b) It is recognised that independent non-executive directors should play a distinctive role, and take the lead where potential conflicts of interest arise. Independent non-executive directors in such circumstances need to have the character and strength to intelligently question matters raised by non-independent directors and not merely 'rubber stamp' proposals before them.

7. Participating conflicted director

- (a) Where a director becomes a participating insider in a potential takeover bid for the company, that director should:
 - immediately advise the board and inform them of any non-public information they may have disclosed to the bidder during the initial communication
 - inform the bidder that all subsequent communication (including requesting any confidential information) should be directed to the board.
- (b) If the director is an executive director, then the board should determine any appropriate protocols that must be adhered to in respect to the continued employment of the person.
- (c) Where a director is a non-executive director, they should in most circumstances immediately offer their resignation from the board to minimise perceived or actual conflict of interest. Boards should be prepared to explain to shareholders why this course of action may not be appropriate in specific circumstances.

8. Board meetings

- (a) Board meetings should be conducted on a regular basis to ensure that the requisite amount of time is spent dealing with board related matters.
- (b) Directors should be provided with appropriately detailed and accurate information in a timely manner prior to board meetings.
- (c) The board should be able to hold regularly scheduled meetings without the CEO or staff present.
- (d) Non-executive directors should also be able to hold meetings without executive and affiliated non-executive directors, the CEO and staff being present.
- (e) Directors should ensure that they attend all board meetings. Boards are encouraged to provide disclosures with regard to director absences. A director who attends fewer than 75% of board and board committee meetings for two consecutive years generally should not be re-nominated unless there are compelling and stated reasons for absenteeism.

Part B. Board structure and processes

9. Chairperson

9.1 Chairpersons responsibilities

- (a) The chairperson must ensure that the board functions effectively and provides the leadership to oversee the operation of the company. A chairperson ensures that appropriate board procedures and structures are in place, so that all relevant issues are considered by the board.
- (b) A chairperson is responsible for a number of key functions, including:
- setting the agenda for board meetings
 - ensuring that a sufficient number of board meetings occur during the year
 - ensuring that the board is provided with adequate information to facilitate effective decision-making, and
 - leading the board in monitoring the management of the company, assessing the company's financial position and performance, establishing a culture which encourages directors to openly discuss risks or any material adverse developments.
- (c) The chairperson performs a critical role in:
- managing the relationship between the board members
 - managing the relationship between the board and the CEO and key senior executives
 - mentoring the CEO, and
 - working closely with the company secretary who is the principal source of information for the chairperson on legal and administrative items.

9.2 Separation of chairperson role from CEO or executive director

- (a) A chairperson should be selected from the pool of independent non-executive directors on the board. ACSI considers that combining the roles of chairperson with CEO or executive director positions creates an unacceptable concentration of power and diminishes the degree of accountability that would usually result from a separation of the two roles. Therefore, the roles of chairperson, CEO and executive director should be separated.
- (b) Where the chairperson is an executive director, the independent non-executive directors should nominate a lead independent non-executive director, or equivalent who will assume leadership responsibilities associated with independent members of the board.

9.3 Multiple chairperson roles

Because of the significant level of responsibility associated with the role of the chairperson, it is not generally acceptable for the chairperson of a listed company to have the same high-level responsibility in a similar position with another listed company. ACSI will consider on a case-by-case basis the capacity of a chairperson in light of other roles they hold.

Part B. Board structure and processes

10. Board committees

10.1 General overview

- (a) A board should ensure that it establishes an audit, remuneration and a nomination committee and any other committees as appropriate for the nature of its particular business. ACSI welcomes the establishment of risk management committees by a number of companies to focus on the mitigation of various risks.
- (b) ACSI believes that board committees perform an important role in dealing with matters where executive directors could face a conflict of interest.
- (c) In general, a committee should be a reasonable size taking into account the size of the board but should not be so large that it comprises a majority of the board. For example, where a company has a board size of nine, then it is anticipated that a committee comprised of three members of the board would be reasonable.
- (d) Where possible, the chairperson of the board should not be the chair of any committee. This will, however, depend on the size of the board.
- (e) The chair of any board committees should be an independent non-executive director.
- (f) Boards should develop terms of reference outlining the scope and responsibilities of these committees. This also includes a policy regarding board expectations about the number of meetings that should occur in the year and the obligations of each director to attend. This information should be disclosed in annual reports.
- (g) The audit committee (including the chair of the committee) should be comprised solely of independent non-executive directors. Remuneration and nomination committees should comprise a majority of independent non-executive directors.
- (h) The members and chairs of the committees must be appointed by the board.
- (i) Although it may be appropriate for committees to invite executives and executive directors to be present at meetings, the committees should be able to meet without executives or executive directors present.
- (j) Committees should have the opportunity to select their own service providers and advisers at a reasonable cost to the company. Companies are encouraged to disclose which material service providers the board and/or committees have appointed, the types of services those service providers have supplied and the type of services supplied by the same service providers to other parts of the company.

10.2 Audit committee

- (a) The audit committee assists the board to discharge its responsibilities in connection with the financial management, financial performance and financial reporting of the company. This includes undertaking an appropriate corporate risk assessment, reviewing the system of internal controls, preparing the company's financial statements and ensuring the independence of the company's auditor and the quality of their audit.
- (b) An audit committee should be able to effectively review and assess the external reporting of the company. Reporting to the board on the performance of internal and external auditors and reviewing internal control mechanisms are fundamental functions of the audit committee.
- (c) The audit committee should have sufficient technical expertise to discharge its mandate effectively.

Part B. Board structure and processes

(d) Key features of an effective audit committee are outlined below:

- written terms of reference are prepared setting out the matters to be dealt with by the committee and the rights and obligations of the committee. This information should be made available to shareholders⁴
- the audit committee is comprised of independent non-executive directors with the required mix of skills, experience and relevant knowledge of the company's operations
- there is a sufficient number of directors on the audit committee who possess the necessary financial expertise to properly fulfil audit committee responsibilities
- the audit committee must have the appropriate powers to review the effectiveness of the external auditor, to make recommendations to appoint, rotate or dismiss the auditors and to establish the scope of the audit
- the audit committee should set the ongoing competency requirements that the auditor must meet
- the audit committee should be able to engage and dismiss internal auditors
- the audit committee should review the safeguards maintained by the external auditor to ensure its independence and the competence of its audit engagement team
- the audit committee should be able to receive reports on all activities of internal and external auditors
- members of the audit committee should be able to liaise with executives, including executive directors, in order to facilitate effective implementation of the committee's objectives
- the audit committee should receive a comprehensive report from the auditor outlining the provision of non-audit work by the audit firm or any related entity and sign off on the quantum of non-audit services to be provided by the audit firm or a related entity
- the audit committee should also have access to external and independent resources in order to properly consider whether the provision of non-audit services is compatible with maintaining the auditor's independence, and
- the audit committee should be able to discuss matters with the external and internal auditors in the absence of management and executive directors.

10.3 Remuneration committee

- (a) The remuneration committee is responsible for developing, reviewing and approving the remuneration of directors and senior executives.
- (b) The remuneration committee should have written terms of reference which include the responsibilities and a mechanism for the regular review of the committee.
- (c) It will advise the board as to whether remuneration, in the case of non-executive directors, realistically reflects the responsibilities and risk involved in being an effective director.
- (d) In the case of senior executive remuneration arrangements, it will ensure that the design and implementation of remuneration packages are linked to the company's performance objectives. ACSI strongly recommends that executives should not be a member of the remuneration committee due to the conflicts of interest that can arise.
- (e) The committee should ensure that it promotes clear and understandable remuneration methodologies that support superior performance and the long-term growth of shareholder value. The committee will assist the board in the evaluation of the performance of the CEO against the various performance measures which underlie his or her remuneration package, including comparison with industry practice or other measures.

⁴ ACSI has released a Model Charter for an Audit Committee which has been prepared by Professor Robert Walker, University of Sydney.

Part B. Board structure and processes

- (f) The committee will be responsible for all aspects of executive remuneration, including design and implementation, contract provisions, retention and termination agreements. This includes being responsible for the appointment of remuneration consultants who report exclusively to the committee and board. Notwithstanding the receipt of external advice, remuneration policies and practices remain the responsibility of the board.
- (g) The remuneration committee is responsible for preparing the remuneration disclosure report, which should be signed off by the board and included in the annual report.

10.4 Nomination committee

- (a) The nomination committee should have written terms of reference which include the matters to be dealt with by the committee and rights of the committee.
- (b) The nomination committee is responsible for:
 - proposing new nominees to the board (after taking into account other external commitments and directorships held by candidates)
 - advising the board on the procedures for assessing existing directors' performance
 - advising the board about the company's policies on the employment of non-executive directors. This would include consideration of the appropriate mix of skills, experience and key competencies required to maximise the effectiveness of the board, and
 - review of board succession plans.

10.5 Independent takeovers committee

- (a) The board should establish appropriate protocols that set out the procedure to be followed if there is a takeover offer for the company including any communication between insiders and the bidder. These protocols should consider establishing an independent takeover committee, and the likely composition and implementation of an independent takeovers committee.
- (b) ACSI supports the establishment of such an independent takeovers committee comprised of non-conflicted directors. In ACSI's view, a conflict of interest could arise where the executive management and/or directors are involved with a bidding party in a takeover.
- (c) The role of the independent takeovers committee is to:
 - create the protocols to manage actual and potential conflicts of interest (for example, potential conflicts of interest may arise where a takeover bid could affect the employment status and eligibility for long-term incentives that form part of executive remuneration packages)
 - ensure that bidding parties and public shareholders have equal access to knowledge about the company
 - establishing rules for disclosing non-public information to the initial and any subsequent bidders
 - ensuring shareholders have sufficient information regarding the structure of the proposed takeover and the bidders identity
 - ensuring that shareholders have sufficient information regarding the identity of participating insiders and incentives offered to them
 - appointing external advisers (including independent experts) if such advisers are likely to add value to the boards discussion about judgment of the fairness of the transaction, and
 - ensure Australian Takeover Panel guidelines are adhered to.

Part B. Board structure and processes

11. Related party transactions

- (a) The board should disclose its policy for managing potential related party transactions, any actual related party transactions and how the board is managing those related party transactions. The board should also disclose the means by which the relevant director or directors managed any conflict(s) of interest during the board's consideration and decision relating to the related party transaction. Investors are entitled to seek such explanations in order to satisfy themselves that the board's decision in the matter was made fully in the best interests of the company.
- (b) The ASX Listing Rule definition of a 'Related Party' provides a useful guide for investors. A related party in relation to a person includes:
 - (i) his or her spouse, de facto spouse, parent, child or a spouse or de facto spouse of that person
 - (ii) an entity controlled by one or more of the persons referred to in paragraph (i)
 - (iii) an entity that he or she controls
 - (iv) a person who acts in concert with anyone referred to above, and
 - (v) a person who was a related party in the previous six months.
- (c) Boards should ensure that they properly disclose all related party transactions in accordance with the Corporations Act and ASX Listing Rule requirements.
- (d) ACSI also believes that boards should avoid relying on a legalistic and narrow interpretation of what constitutes a related party and ensure that not only the legal requirements are observed, but also the spirit underpinning those requirements.

12. Indemnity and liability of directors

- (a) The company should indemnify directors for reasonable legal expenses for actions brought in consequence of the exercise of judgement in connection with their service as directors.
- (b) Directors should be accountable to the shareholders and the company for violations of their duty of loyalty involving gross or sustained and repeated negligence or illegality or other transgression.

13. Rights of directors

- (a) Before their appointment as directors, a company should provide directors with an outline of their rights and obligations arising out of the company's constitution, the Corporations Act and other relevant instruments.
- (b) Directors should have access to training from independent sources to provide them with a clear understanding of their directors' responsibilities and liabilities.
- (c) Directors should have reasonable access to the company's employees, information and resources and be able to obtain independent professional or other advice at reasonable cost to the company in order to assist them in carrying out their duties.

14. Evaluation of board performance

- (a) The board should have mechanisms to evaluate and improve its performance in governing the company.
- (b) The board should disclose its approach to regularly assessing the performance and effectiveness of individual directors and the board as a whole, measured against criteria set by the board.
- (c) The purpose of board evaluation is to review an individual director's contribution and to identify gaps in skills, experience and expertise that would need to be addressed in order to promote board effectiveness and company performance over the long-term.

Part C. The board and company executives

15. Chief Executive Officer (CEO)

15.1 CEO responsibilities

The CEO is responsible for managing the organisation in accordance with the strategic objectives that have been endorsed by the board, by harnessing appropriate human, financial, technical and administrative resources.

15.2 Performance of the CEO

- (a) The continuity of strong leadership is a primary and exclusive responsibility of the board. There must be a clear understanding between the CEO and the board regarding the expected performance requirements of the CEO and how that performance will be measured.
- (b) Boards should evaluate the performance of the CEO at least annually. The performance objectives should include both annual and sustained multi-year performance periods.

16. Remuneration

Executive incentive arrangements provide a tangible insight into the effectiveness, or otherwise, of boards in attracting, retaining and motivating key management personnel. How executives are remunerated also provides investors with an insight into the relationship between the board and executives. Boards therefore have a primary role in establishing remuneration policy in order to attract and retain highly competent executives.

CEO's and senior executives influence the direction of companies, which ultimately affects shareholder return. Therefore, executive remuneration should promote superior performance of a company.

ACSI believes that boards should always be encouraged to put in place remuneration arrangements that reward success, not mediocrity or failure.

16.1 Remuneration practices

- (a) ACSI recognises that boards have a critical role in attracting, retaining and motivating executives through remuneration policy. The overall size of remuneration should be reasonable but not excessive in order to achieve these objectives.
- (b) Remuneration reports provide an effective mechanism for investors to consider the remuneration policies of companies. In particular, the remuneration report enables shareholders to convey a view on those practices when casting a 'non binding' vote. The report should outline all key aspects regarding the determination of remuneration policy, in particular the linkage between the policy and performance in the interests of promoting long-term shareholder value.
- (c) In order to avoid overly legalistic and technical explanations that would appear to complicate good disclosure, ACSI encourages a narrative approach to remuneration reporting whereby companies use the remuneration report to explain why remuneration practices are appropriate for the company and those covered by the report.
- (d) The board should report the remuneration practices that are applicable to non-managerial employees, management employees and executives.

Part C. The board and company executives

- (e) Because executives are responsible for influencing the direction of the company, which ultimately affects shareholder return, executive remuneration should promote superior performance of a company against comparable peer group(s) over the long-term. Executive remuneration has the potential to damage reputation, affect employee morale and affect behaviour. Getting the balance on time scale and appropriate performance measures is critical.⁵
- (f) Executives should not derive significant remuneration benefits in the absence of a direct contribution to long-term superior financial performance of the company.
- (g) Remuneration should be regarded as a key tool to motivate executives and employees and harness their support of the long-term growth and success of the company.
- (h) In broad terms, a properly structured remuneration scheme for executives should:
 - be reasonable in remunerating executives in a way which is aligned with shareholder interests
 - strike a balance between shareholder and executive expectations, in particular with respect to determining the overall amounts of company profits to apply to executive compensation and reward
 - be measurable against key corporate performance indicators
 - be sufficiently market-oriented, within levels of comparability for similar peer group companies in the context of industry, size and business focus
 - be properly and comprehensively described to shareholders including base cash remuneration, short-term bonuses and longer-term incentives or other rewards
 - separately outline details relating to fixed remuneration, bonuses and incentives and share scheme arrangements
 - be fully disclosed, valued and expensed in accordance with regulatory requirements, and
 - be acceptable to shareholders.

16.2 Termination payments

- (a) When a company appoints a senior executive, ACSI acknowledges that ASX Listing Rule 3.1 requires the company to disclose the contractual terms (including termination conditions) of that appointment. As part of that disclosure, ACSI also encourages companies to include the potential value of the termination payout for the senior executive, in order to eliminate the element of surprise for shareholders in the future.
- (b) A company should disclose its policy on notice periods and termination payments in Executive Service Agreements. This includes reference to compensation provisions that are applicable upon the termination of an executive's employment. The relevant 'triggers' for termination that arise should be disclosed.
- (c) ACSI would support bringing Australian disclosure provisions relating to Executive Service Agreements in line with US provisions that compel listed companies to file a copy of Executive Service Agreements with the Securities and Exchange Commission (SEC) at the time a senior executive is hired. This ensures that the contractual provisions dealing with a potential termination payout are made public contemporaneously with the hiring of the executive. This will overcome the latitude that is currently available to Australian companies to disclose key details of Executive Service Agreements, such as termination provisions, as late as 15 months after the executive is hired - when the next annual report is published.

⁵ ICGN Remuneration Guidelines, published July 2006.

Part C. The board and company executives

- (d) A company should ensure that an Executive Service Agreement provides a reasonable basis to procure the early termination of an executive where the executive has performed poorly and inadequately against previously agreed benchmarks.
- (e) Boards should therefore be discouraged from paying out excessive and unreasonable termination payments in circumstances where the termination is a consequence of poor and inadequate performance.
- (f) Properly constructed 'liquidated damages' clauses are one way of restricting payouts to executives who depart following a period of poor performance. These clauses typically allow for termination payments even where the executive's performance has been below a required standard (though not so bad as to constitute dismissal for 'cause'), but the size of the payout is delimited in advance.

ACSI supports liquidated damages clauses in Executive Service Agreements that:

- provide a maximum liquidated damages payout of no more than 12 months' base salary, and
 - provide that no amount (other than statutory entitlements such as accrued leave) is payable where the executive is dismissed for cause, i.e. misconduct, wilful neglect or serious breach of the Executive Service Agreement.
- (g) In circumstances where an executive is dismissed for underperformance (not amounting to cause), the Executive Service Agreement should provide that all unvested performance and incentive-related elements of the executive's remuneration package are forfeited. There should be a clearly defined, and not excessive, time-frame during which vested options and other incentive instruments may be exercised, provided that performance hurdles have been satisfied prior to termination.
 - (h) In circumstances where an executive is dismissed for cause, the Executive Service Agreement should provide that all performance and incentive-related elements of the executive's remuneration package are forfeited. This includes options and other incentive instruments that are unvested at the time of dismissal, and also options and other incentive instruments that have vested but have not been exercised at the time of dismissal.
 - (i) ACSI supports the introduction of UK-style proposals that provide for the outstanding term of a contract to be paid in 'phased' termination payments that cease when an executive finds other employment.
 - (j) ACSI supports legislative reform that would provide shareholders with a greater say on termination benefit payments. Existing caps currently applicable under sections 200F and 200G of the Corporations Act, that allow for shareholders' approval of termination payments that exceed seven-times annual remuneration are considered to be too generous. ACSI considers that termination benefits worth more than 12 months' base salary should require approval by shareholders.
 - (k) Section 16.11 details ACSI's policy with regard to options and performance rights following retirement and resignation.

16.3 Disclosure, valuation and expensing of remuneration

It is of critical importance that all elements of remuneration, including all fixed and variable components, are properly disclosed, valued and expensed. A company should ensure that it meets the various disclosure requirements arising out of the Corporations Act. This also includes the requirement to appropriately value remuneration arrangements under the Corporations Act.

Part C. The board and company executives

16.4 Fixed remuneration

- (a) Fixed remuneration is a component of the total compensation of all employees in the company. It should take into account legal, industrial and other obligations of the company.
- (b) In relation to executive remuneration, the fixed component of a remuneration package should be relative to the scale of business as measured by sales, assets, number of employees and total market capitalisation.
- (c) As a general rule fixed pay should not be so high that incentive elements are not regarded as remuneration 'at risk' by executives; nor so low as to impinge on the executive being able to meet his or her essential financial commitments.⁶
- (d) General increases in fixed remuneration for executives should be considered in light of an executive's total remuneration and have regard to the rate of increases applicable to the rest of the company's workforce. The rationale behind a substantial increase in fixed remuneration for executives should be disclosed by the company including why substantial increases are warranted in light of both the circumstances of the company and the performance of the relevant executive.

16.5 Variable remuneration

- (a) Variable remuneration includes short-term incentives (such as an annual bonus) and long-term incentives (such as share options or share-based incentives).
- (b) All variable remuneration schemes should be provided in reasonable amounts, should generally be valued at a level that is a reasonable and explainable multiple of the executive's fixed remuneration and be underpinned by clear and relevant performance hurdles.
- (c) In general ACSI will not support amendments to variable remuneration which effectively lead to a 'de-risking' of executive pay. Where company performance and shareholder value has declined, executive incentives that are promoted as 'at risk' should generally also decline on a proportionate basis.

16.6 Performance conditions for short-term incentive schemes

- (a) With respect to annual bonuses that are usually paid in cash, these payments should be linked to clear key performance requirements and predetermined targets. Such requirements should generally be disclosed in the company's remuneration report subject to 'commercial in confidence' requirements.
- (b) Where commercial confidentiality applies, in accordance with the Corporations Act requirements, companies should disclose the parameters adopted in the financial year for the bonus arrangements or alternatively the conditions that apply retrospectively.

16.7 Retention payments

- (a) The remuneration policy and practices (including incentive arrangements) should adequately factor in retention mechanisms for executives.
- (b) If retention benefits or sign-on benefits (including golden handshakes) are made to executives, whether upon joining or during the executive's tenure, the benefits should be disclosed and subject to a holding lock of between one to three years.

⁶ AICD 'Executive Remuneration Guidelines for Listed Company Boards' February 2009.

Part C. The board and company executives

16.8 Performance conditions for long-term incentive schemes

- (a) The performance conditions for long-term incentive schemes (e.g. share option plans and share-based incentive plans) should be designed to reward executives for contributing to long-term, above average corporate performance. To ensure that executives are only rewarded for sustained risk adjusted performance, boards are encouraged to stress test proposed performance metrics.
- (b) Companies should explain how high levels of potential reward are tied to stretching and demanding performance conditions, particularly where a company makes an annual grant of options (or other long-term incentive awards) the value of which exceeds one times base salary.
- (c) ACSI encourages the utilisation of forward-looking dual performance hurdles which measure the company's performance on an absolute and relative basis, to be satisfied before any share options or other long-term incentive instruments vest.
- (d) An example of an 'absolute' measure of performance includes a company's earnings per share exceeding a target established by the board. In this regard, a target should be sufficiently demanding.
- (e) An example of a 'relative' performance measure is where the company's total shareholder return must place the company at a certain point in a ranking against an identified set of peers.
- (f) ACSI will, however, accept the utilisation of one performance hurdle, preferably a relative performance measure that is sufficiently challenging and requires the achievement of out-performance against relevant and disclosed external benchmarks.
- (g) In general, ACSI will not support remuneration schemes, or proposed grants of incentives under them, where performance hurdles are not sufficiently demanding. What will be regarded as sufficiently demanding is a case-by-case judgement; however, the following guidance is of general application:
 - where a relative hurdle is used, there should be no vesting unless the company's performance is ahead of at least half of peer companies
 - ACSI is generally supportive of hurdles which allow for 'variable reward' - under which the number of options (or other long-term incentive instruments) that vest increases on a sliding scale according to the level of corporate performance achieved
 - ACSI does not support hurdles that allow for all options (or other long-term incentive instruments) to vest for median, or slightly better than median, performance
 - where a share incentive scheme provides for 'performance rights', 'performance shares', 'deferred shares' and other zero exercise price options (zepos) with an exercise price of zero, it is particularly important that challenging performance hurdles are in place. This is because these instruments lack the inherent share-price appreciation hurdle that traditional options possess. ACSI in general would not consider an absolute accounting based hurdle stretching where the scheme provides zepos
 - performance hurdles need to be explained clearly - both in the annual report and also in the notice of meeting - when a grant of options (or other long-term incentive instrument) is put to shareholders for approval. Information about the hurdle needs to be sufficient in detail and clarity, to enable investors to determine whether it will allow for executives to be rewarded only if long-term corporate performance is enhanced
 - ACSI is generally opposed to re-testing, but is prepared to assess each case on its merits, as detailed in Section 16.10, and
 - performance hurdles are equally important for loan-funded share plans, as detailed in Section 16.13.

Part C. The board and company executives

16.9 Other aspects of long-term incentive schemes

(a) Types of schemes

- (i) companies may provide share option schemes for their executives or promote share incentive and reward schemes as an appropriate method of long-term variable remuneration
- (ii) although share incentive and reward schemes may not result in the same dilutive impact on existing shares as a share option arrangement, a share incentive scheme may in itself be unacceptable if it has insufficiently demanding performance hurdles
- (iii) share option schemes providing options in reasonable amounts and with challenging performance hurdles can still be regarded as a reasonable incentive for executives. The key considerations for option schemes are that they should have reasonable conditions of issue, be issued in reasonable quantities, and be properly disclosed, valued and expensed.

(b) Frequency of grants

The board should ensure that grants of options (or other long-term incentive awards) are made regularly (e.g. annually) in preference to one large tranche every three or four years. This is designed to:

- reduce the risk of unanticipated outcomes that arise out of share price volatility and cyclical factors
- reduce the possibility that a limit on existing options encourages early exercise
- allow the adoption of a single performance measurement period, and
- reduce the possibility of 'underwater' options, where the share price falls below the exercise price.

(c) Exercise price

- (i) the exercise price for options should not be less than the average of the share price on the five days of trading before the options are granted
- (ii) scheme rules should not be altered to make it easier for the executive to exercise options where there has been a fall in share price or performance (i.e. repricing of options and adjustment of targets)
- (iii) option scheme rules should not give the board, a board committee, or the plan administrator discretion to lower the exercise price of options that have already been awarded, where the market price of the shares has fallen below the original exercise price
- (iv) a company may bring about substantially the same result as repricing by granting a new tranche of options to its executives if last year's grant is now underwater. Some Australian companies have replaced underwater options in this way in previous years. ACSI does not support this practice.

(d) Vesting period

- (i) grants of options and other long-term incentive instruments should incorporate a minimum vesting period of at least three years. However, in general ACSI has a preference for longer vesting periods
- (ii) where a scheme utilises phased vesting schedules, that is, where options or rights vest in tranches (e.g. one-third of options vest after three years; one-third vest after four years; and one-third vest after five years), then each tranche of awards should be linked to sustained performance requirements.

(e) Holding lock

A holding lock is a requirement that shares received on exercise of options, or after performance rights vest, must be retained for a further defined period of time. ACSI supports a holding lock period of between one to three years.

Part C. The board and company executives

(f) Disclosure

The following information should be disclosed:

- the expiry date for options or other long-term incentive instruments, when a grant of options (or other long-term incentive instruments) is put to shareholders for approval
- the number of shares available or eligible for issue and actually issued under the option scheme or share-based incentive scheme
- the value and number of share options and shares granted, exercised and outstanding under all incentive plans, in accordance with the Corporations Act
- the value of those options or instruments where shareholder approval is being sought for a particular grant of options or other long-term incentive instruments
- the valuation method used to value options. In particular, any discount factor applied as part of the valuation (e.g. to take account of the possibility of performance hurdles not being satisfied in whole or in part, or to take account of executive leaving the company and surrendering options)
- the exercise price of share options (or the method of determining it), and
- the company's policy with regard to the treatment of dividend payments on unearned shares that form part of any long-term incentive scheme.

(g) Valuation and expensing

- (i) in relation to the requirement to value share options and other long-term incentive instruments, companies should utilise an internationally recognised method of valuation in order to meet the requirements of the Corporations Act and Accounting Standards
- (ii) grants made under share incentive and option schemes should be properly expensed in company financial statements in accordance with the appropriate accounting standards. Boards should ensure that they are sufficiently apprised of the requirements of these standards and apply them accordingly in the relevant disclosure provisions in annual reports.

(h) Dilution

- (i) the dilutive impact of share option and share incentive plans on existing shareholders should not be excessive. This will generally depend on the value of options and shares issued and the position of the company, particularly whether it is a new and emerging company or one that is established and mature
- (ii) ACSI's concerns with regard to dilution also apply to shares purchased on market using company funds on behalf of employees
- (iii) in general, prior shareholder approval should be required where any single share or share option scheme could result in shares equal to 5% or greater of total issued ordinary shares being allocated. Generally, the total number of shares and options for executives and employees, under all schemes, should not exceed 10%. ACSI will consider, on a case by case basis, share and share option schemes that provide for a total potential dilution (under all the company's schemes) of up to 10%
- (iv) ACSI will not support share or share option plans, or grants under those plans, where the 'flow rate' (i.e. the total number of options and shares granted in any one year, expressed as a percentage of total issued ordinary shares) exceeds 2%. ACSI will consider, on a case-by-case basis, plans, and grants under plans, where the flow rate exceeds 1% but is less than 2%. A flow rate of less than 1% is generally acceptable.

Part C. The board and company executives

16.10 Re-testing of performance hurdles

Where performance conditions or hurdles have not been met at the vesting date, the ability to 're-test' the hurdle on a future date or dates is an unacceptable aspect of corporate governance in some countries. ACSI is generally opposed to re-testing, but is prepared to assess each proposal on a case-by-case basis.

16.11 Options and performance rights following retirement or resignation

- (a) Options (or other long-term incentive instruments) should be exercised within one year after retirement or otherwise they lapse. Performance conditions should not be waived.
- (b) ACSI will consider proposals that allow for a pro rata number of options/performance rights to be exercisable where the executive resigns from the company during the vesting period.
- (c) Section 16.2 details ACSI's policy in relation to the treatment of long-term incentives where an executive is dismissed for cause or for poor performance.

16.12 Change of corporate control

- (a) ACSI does not support the full vesting of options and performance rights in the event of a takeover or change of control in the company, irrespective of how far into the vesting period the options are and whether or not performance hurdles have been satisfied.
- (b) However, ACSI is prepared to consider the pro rata vesting of options/performance rights, to take into account any period of vesting that has accrued up until the time of change of control.

16.13 Loan-funded share plans

- (a) ACSI does not support loans to be made to executives on a non-commercial basis, so that they may take up shares.
- (b) With respect to non-recourse or limited recourse loans, ACSI supports share plans that provide that where shares are forfeited by an executive, the company is able to sell the shares on-market to recoup some or all of what was owed by the executive. In order to minimise a potential cash loss to a company ACSI prefers the use of newly issued shares in such schemes.
- (c) ACSI views loan-funded share plans as analogous to option plans, and therefore expects challenging performance hurdles to also apply to loan-funded share plans.

16.14 Option hedging

- (a) ACSI does not support companies allowing their executives to obtain financial products to remove the risk associated with share options in their remuneration package where they have not vested. This practice negates the rationale for variable remuneration schemes that should apply when an executive has contributed to above average corporate performance.
- (b) ACSI encourages companies to disclose if they have a policy in relation to option hedging and they are further encouraged to disclose when it is implemented.
- (c) In order that shareholders can make informed decisions based upon amongst other things, a director or executive's share trading and to ensure confidence in the integrity of the market, where a company permits directors and senior executives to hedge their vested incentives, the company should inform the market about the transaction within 2 days of it occurring.

Part C. The board and company executives

16.15 Director remuneration and share ownership

- (a) All forms of remuneration paid to directors should be disclosed in accordance with Corporations Act and ASX Listing Rule requirements. Companies are encouraged to disclose the rationale for proposed aggregate non-executive director fee cap increases and how this will be apportioned to existing non-executive directors when an increase in the fee cap is being sought. ACSI expects that the fee cap will cover all fees paid to directors, including base fees, committee fees and superannuation.
- (b) Independent non-executive directors should be encouraged to acquire shares from an allocation of fees paid for undertaking their directorship.
- (c) ACSI does not support the creation of a retirement benefit plan for independent non-executive directors (excluding Superannuation Guarantee payments). Where, for historical reasons, a retirement benefit plan is in place ACSI would support companies freezing those benefits (with appropriate indexation).
- (d) All monetary arrangements with directors for services outside normal board activities should be approved by the remuneration committee of the board.

17. Shareholder rights and proxy voting

The right of shareholders to exercise their votes is the most visible tool available to trustees to influence the governance practices of companies.

ACSI believes that all superannuation funds should be exercising all of the votes associated with their shares, all of the time.

Voting is not an end in itself however it enables investors to demonstrate their interest in the governance practices of companies. Superannuation funds are long-term owners, as interested owners of shares. This is considered important given that superannuation funds have an extended interest in the long-term direction of these companies.

17.1 Role of proxy voting

- (a) Access to the proxy voting process is an important means by which shareholders can ensure that directors are held accountable for their actions and the future direction of the company.
- (b) Proxy voting is therefore a key mechanism by which shareholders play a role in the governance of the company. General principles of shareholder rights require companies to encourage shareholder access to the proxy process.

17.2 Voting rights and procedures

- (a) ACSI supports initiatives adopted by companies to overcome some of the impediments and constraints to more active shareholder involvement. The Corporations Act, the constitution of the company and the ASX Listing Rules outline in detail the rights of shareholders in relation to calling a general meeting, resolutions, proxies and voting requirements.
- (b) These provisions should provide balanced requirements on a company without setting impossible benchmarks for shareholders to utilise, particularly in relation to calling general meetings or proposing resolutions.
- (c) ACSI supports legal mechanisms to improve participation, particularly through electronic communications and voting processes.
- (d) Outlined below are general supplementary principles related to other initiatives that ACSI supports:
 - (i) Voting:
 - a 'one share/one vote' policy
 - voting by shareholders should be confidential, democratic and transparent
 - resolutions should not be bundled so that shareholders should be allowed to vote separately on unrelated issues
 - equal weighting should be given to votes cast in person or by proxy
 - shareholders should be given the right to vote on corporate governance decisions such as director election/re-election, executive and director remuneration policy, appointment of external auditor and all constitutional document changes
 - shareholders should approve the acquisition of securities in the company for a director, unless it is under a bona fide salary sacrifice arrangement from an executive's fixed remuneration
 - voting by poll so that resolutions are passed according to level of share ownership and not merely relying on a show of hands at a general meeting, and
 - procedures should ensure that votes are properly counted and recorded.

Part D. The company's relationship with its shareholders

(ii) Information Disclosure:

- provision of adequate, accurate, unbiased and timely information to enable informed decisions by shareholders
- additional information regarding a general meeting item should be made available upon request
- shareholders, including beneficial owners of shares, should be able to receive documents directly from the company
- shareholders should have reasonable access to minutes of general meetings
- companies should announce the outcomes of a vote and publish it on their web-site following each general meeting
- companies should provide appropriate disclosure in relation to how undirected proxies have been voted by the chairperson, and
- ACSI encourages companies to disclose on their web-site information about beneficial holding details obtained within two days of receiving the information. This complements the requirement for companies to make the information publicly accessible through an entry in their register.

(iii) General Meetings:

- secure electronic voting over paper-based voting
- chairpersons should vote proxy votes in accordance with the way they are directed, and
- shareholders should be able to ask questions of the board, management and auditors at general meetings.

17.3 Shareholder meeting rights

- (a) Appropriate notice of shareholder meetings, including notice concerning any change in meeting date, time, and place or shareholder action, should be given to shareholders in a manner and within time frames that will ensure that shareholders have a reasonable opportunity to exercise their vote. ACSI supports the retention of a 28-day notice of general meeting for listed companies.
- (b) Where possible, all directors, senior executives and the external auditor should attend annual shareholders' meetings and be available, when requested by the chairperson, to answer shareholder questions.
- (c) Polls should remain open at shareholder meetings until all agenda items have been discussed and shareholders have had the opportunity to ask and receive answers to questions concerning them.
- (d) Companies should not adjourn a meeting for the purpose of soliciting more votes. Adjourning a meeting should only be done for compelling reasons such as vote fraud, problems with the voting process or lack of a quorum.
- (e) Companies are encouraged to hold shareholder meetings by remote communication (i.e. electronic meetings) only as a supplement to traditional in-person shareholder meetings and not as a substitute. Companies should utilise appropriate forms of technology to facilitate secure electronic voting.

17.4 ASX corporate governance council principles

Companies should ensure that they prepare clear and informative responses to the ASX Corporate Governance Council Principles and Recommendations, and that they provide shareholders with an understanding of the company's approach to the Principles.

Part D. The company's relationship with its shareholders

17.5 Existence of controlling shareholders

- (a) Where companies have controlling shareholders, there should be adequate safeguards for minority and non-controlling shareholders built into board structures and constitution as follows:
- there should be disclosure in the annual report and accounts of all connections and relationships past and present between directors and controlling shareholders
 - the existence of any relationship agreements should be disclosed, and
 - the chairperson should not have any connection to the controlling shareholder.
- (b) Where the controlling shareholder owns or controls, singly or jointly, more than 50% of the voting rights, the controlling shareholder should abstain from voting on the election of any director related to the controlling shareholder.

18. Board accountability to shareholders

- (a) Corporate governance structures and practices should protect and enhance accountability of boards to shareholders.
- (b) The board should submit, for prior shareholder approval and action, any proposal that alters the fundamental relationship between shareholders and the board. For example, major corporate changes, which in substance or effect may impact shareholder equity or erode share ownership rights, should be submitted to a vote of shareholders. Sufficient time and information should be given to shareholders (including balanced assessment of relevant issues) to enable them to make informed judgements on these resolutions.
- (c) The board should respond, where practicable, to communications from shareholders. In particular, shareholders should have access to non-executive directors.
- (d) Any shareholder proposal approved by a majority of votes cast should either be adopted by the board, or the next annual report should contain a detailed explanation of the board's progress towards the introduction of the proposal.

19. Stapled and externally managed entities

- (a) ACSI considers that notwithstanding any Corporations Act requirements, stapled and externally managed entities should comply with the spirit of the ASX Corporate Governance Council's Principles.
- (b) In particular, ACSI would encourage such entities to:
- have boards that comprise a majority of directors who are independent of the external manager and are not appointed by the external manager
 - appoint auditors who are separate from the auditors of the external manager
 - ensure that remuneration arrangements for the external manager are aligned with shareholder interests, and
 - disclose the basis on which management fees are calculated including the potential termination fees that would be payable.

20. Continuous disclosure

- (a) Companies should ensure that they have the appropriate processes and structures in place to effectively meet existing continuous disclosure requirements.
- (b) All information provided to shareholders should be true and fair, even where contentious issues are at stake.
- (c) Companies should ensure that they release sufficient information to enable all investors to make informed and accurate judgements about issues that could impact on the value of their shareholdings.
- (d) The timely release of, and equal access to, information is important to ensure that all investors are properly informed. This is particularly important in takeover situations where the board or the independent takeover committee should ensure that there is adequate and equal (where possible) disclosure to shareholders.
- (e) The board of directors 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 company so that shareholders understand how the company deals with those issues.

21. Disclosure of environmental, social and corporate governance policies and practices

- (a) Disclosure is the key to building confidence and allowing investors to better understand, evaluate and assess investment risk and return. Investors require enough information from companies to be reassured that material environmental, social and corporate governance risks are being considered, that there are processes in place to manage those risks, and that those processes are effective.
- (b) ACSI encourages companies to disclose information on each of the following matters, as far as they are relevant and material to the company's operations:
 - relevant environmental, social and corporate governance policies
 - the company's assessment of important environmental, social and corporate governance risks, especially those that are potentially financially material
 - the governance framework and strategies for managing key corporate governance, environmental and social issues
 - how the company's management of environmental, social and corporate governance issues is linked to and integrated with its business strategy, including policies and objectives, targets and key performance indicators for material governance issues, progress on meeting those objectives and targets, and how progress is monitored and measured
 - environmental management, including:
 - all material environmental aspects impacted by the company's operations, including impacts to air, water, land, biodiversity and species distribution, human health, energy consumption and waste generation
 - the potential impact of climate change and potential carbon pricing on the company
 - resource use (including water and energy consumption and waste generation)
 - human capital management (including issues such as recruitment and retention strategies, workplace bullying and harassment policies, whistleblower policies, training and development, performance planning and career management processes, equal opportunity and workplace diversity policies and practices, workplace health and safety practices, labour relations and labour rights)

Part E. Company disclosure

- supply chain management (both environmental and social issues, such as human rights)
 - how the company manages its relationships with its stakeholders including the community in which it operates
 - customer satisfaction rates, and how they are measured
 - the company's corporate philanthropic practices. Investors expect companies to explain how their philanthropic activities are linked to their business strategies
 - any other matters the company believes is relevant.
- (c) ACSI recognises that:
- the environmental, social and corporate governance risks relevant and material to companies in different industry sectors, and to individual companies within in each sector, will vary and as such so will disclosure of such risks
 - companies need time to build internal systems and capability to capture and measure the relevant information to be able to provide meaningful disclosure, and that a company's reporting on environmental, social and corporate governance factors will evolve over time
 - a company will need to balance disclosure with the protection of commercially sensitive or confidential information.
- (d) ACSI encourages companies to disclose their environmental, social and corporate governance issues in a form that is consistent with existing disclosure frameworks, such as the Global Reporting Initiative and the Carbon Disclosure Project.⁷
- (e) A company's disclosure of environmental, social and corporate governance issues should:
- be material and relevant
 - be made available as soon a reasonably possible
 - be easily accessible and, where appropriate, integrated with financial information
 - use objective metrics where they apply and evidence-based estimates where they do not.⁸
- (f) ACSI encourages companies to consider independent third party assurance of reports, once they have developed their approach to environmental, social and corporate governance matters.

⁷ For more information about the Carbon Disclosure Project, please visit www.cdproject.net. For more information about the Global Reporting Initiative, please visit www.globalreporting.org

⁸ This section is adapted from the ICGN Statement and Guidance on Non-financial Business Reporting, released in December 2008. A copy can be obtained at the International Corporate Governance Network's homepage: www.icgn.org

22. Disclosure of board information

- (a) Disclosure of information about the directors and the board is critical to enable shareholders to form a proper judgement about the effectiveness of the board.
- (b) In addition to existing Corporations Act disclosure requirements, the disclosure of the following matters to shareholders significantly improves the transparency of the operation of the board:
- the cycle of board and committee meetings
 - the availability of the terms of reference for the board and its committees
 - when disclosing directors' attendance records at board and committee meetings, those disclosures should distinguish between in-person and other attendance (e.g. telephone or video conferencing). Excused absences should not be categorised as attendance
 - procedures and responsibilities in place to appraise the performance of the board, committees and individual directors
 - procedures and responsibilities for succession planning
 - full biographies for all directors, including dates of appointment, ages, career history prior to and in the company (in the case of executive directors), other directorships and significant positions in public, commercial and political life and ongoing training
 - any regulatory or statutory breaches of professional conduct
 - director's remuneration and its components so that shareholders can make proper assessments of the genuine value of a director's package
 - information necessary for shareholders to determine whether each director qualifies as independent. To assist shareholders in making these determinations, boards should disclose all financial or business relationships with, and payments to, directors and their families and all significant payments to companies, non-profit foundations and other organisations where the directors serve as employees, officers, or directors (Section 5.1 provides further details about independent non-executive directors), and
 - the main terms of each director's service contract or other contractual terms or letters of appointment.

23. Disclosure, trading and voting rights in company shares

- (a) A company should disclose its policy with respect to trading and voting in company securities by directors, officers and employees. The policy should set out the rules applying to directors or senior executives entering into margin loans over the company's shares, the requirements of such loans to be made known to the company and the policy of the company towards the disclosure of such loans to the market where the holdings and/or exposures are material.
- (b) Due to the inherent conflict of interest executive directors should not vote on the remuneration report or any other resolution such as grants of incentives that pertain to their own remuneration.
- (c) ACSI supports boards disclosing directors and senior executives (including the CEO) share trading within 2 days.
- (d) ACSI supports an approach that restricts the times directors may trade shares to specific 'trading windows'. Directors:
- should not deal in any securities of a listed company during a 'closed period' which is a period of:
 - two months immediately preceding the preliminary announcement of the company's annual results
 - two months prior to announcement of half yearly reports
 - one month prior to announcement of quarterly results
 - may deal outside the closed period following receipt of clearance by the chairperson. The chairperson is required to receive clearance from the whole board, and
 - should not apply to buy or sell shares (either directly or indirectly) of another company about which they have price-sensitive information arising from their directorship of the company.

Part F. The company's financial integrity

24. Corporate financial integrity

- (a) It is of critical importance that the system of financial reporting of a company provides an accurate and true representation of its financial position.
- (b) The board and auditors should undertake sufficiently detailed analysis and enquiry into the company's accounts to ensure that all Australian accounting standards have been met.
- (c) ACSI supports the requirement for a company's CEO and the Chief Financial Officer to certify to the board that all relevant financial information has been presented to the board and that this provides a true and fair view of the company's financial position and affairs.

25. Relationship with the auditor

25.1 External auditors

- (a) Shareholders are entitled to have high levels of confidence in the financial statements of a company. These statements should provide an accurate and detailed account of the company's financial position.
- (b) In this regard, external auditors play a key role in verifying the accuracy of financial statements for the benefit of all shareholders. An important obligation of auditors is to certify that the company's accounts represent a true and fair view of the affairs of the company. It is fundamental that auditors discharge their duties and responsibilities without being influenced by factors that could impede, or be perceived to impede, their independence. Accordingly, auditors should attend Annual General Meetings to answer questions from shareholders in relation to the accounts and external audit.

25.2 Auditor independence

- (a) Auditors are required to be, and be seen to be, independent and free of any interest which might be regarded as being incompatible with integrity and objectivity. For an auditor to be independent, there should be no significant financial, business or employment relationship between the company and the signing audit partner and the audit firm. The existence of such relationships may create self-interest, familiarity or the threat of intimidation, all of which compromise the integrity of the audit.
- (b) Financial relationships arise where the auditor:
 - directly invests in the company
 - has a material indirect financial investment in the company, or
 - is involved in loans to and from the company.
- (c) Business relationships arise where the audit firm or a member of the audit engagement team has a business relationship with the company or an officer of the company, which is not insignificant to the audit team member/firm of the company.
- (d) Employment relationships arise where the company employs:
 - a current or former partner of an audit firm or an employee of an audit firm, or
 - an immediate family member of a member of the audit engagement team who is in a position to affect the subject matter of the audit engagement.

Part F. The company's financial integrity

25.3 Provision of non-auditing services

- (a) ACSI considers that an audit firm can provide a limited range of non-auditing services, provided that the fees paid for non-audit work and the level and nature of non-auditing work performed is disclosed in the financial reports of the company. An audit firm should submit a comprehensive report to the audit committee outlining the provision of non-audit work by the firm or any related entity.
- (b) The audit committee should verify that it has considered and signed off on the quantum of non-audit services to be provided by the audit firm or a related entity. If it cannot so verify, then the audit firm should be changed.
- (c) ACSI believes that the following services should not be provided by the same audit firm performing the audit for the company, as they may be perceived to be materially in conflict with the role of the auditor:
- preparing accounting records and financial statements
 - valuation services
 - internal audit services
 - IT system services
 - broker or dealer services
 - investment advice
 - investment banking services
 - legal services, and
 - strategic taxation advice.

25.4 Auditor familiarity

Signing audit partners should be rotated every five to seven years. The audit committee should be involved in an ongoing review of the audit firm and its services, with active consideration given to rotating the audit firm every ten to twelve years. Where the audit firm is rotated, the personnel who assume responsibility for conducting the audit should not be the same personnel (for example, situations could arise where an audit partner moves firms and could continue to be responsible for auditing the company).

25.5 Auditor competency

The auditor must meet appropriate ongoing competency requirements that are set down by the audit committee.

25.6 Auditor to provide statements of independence

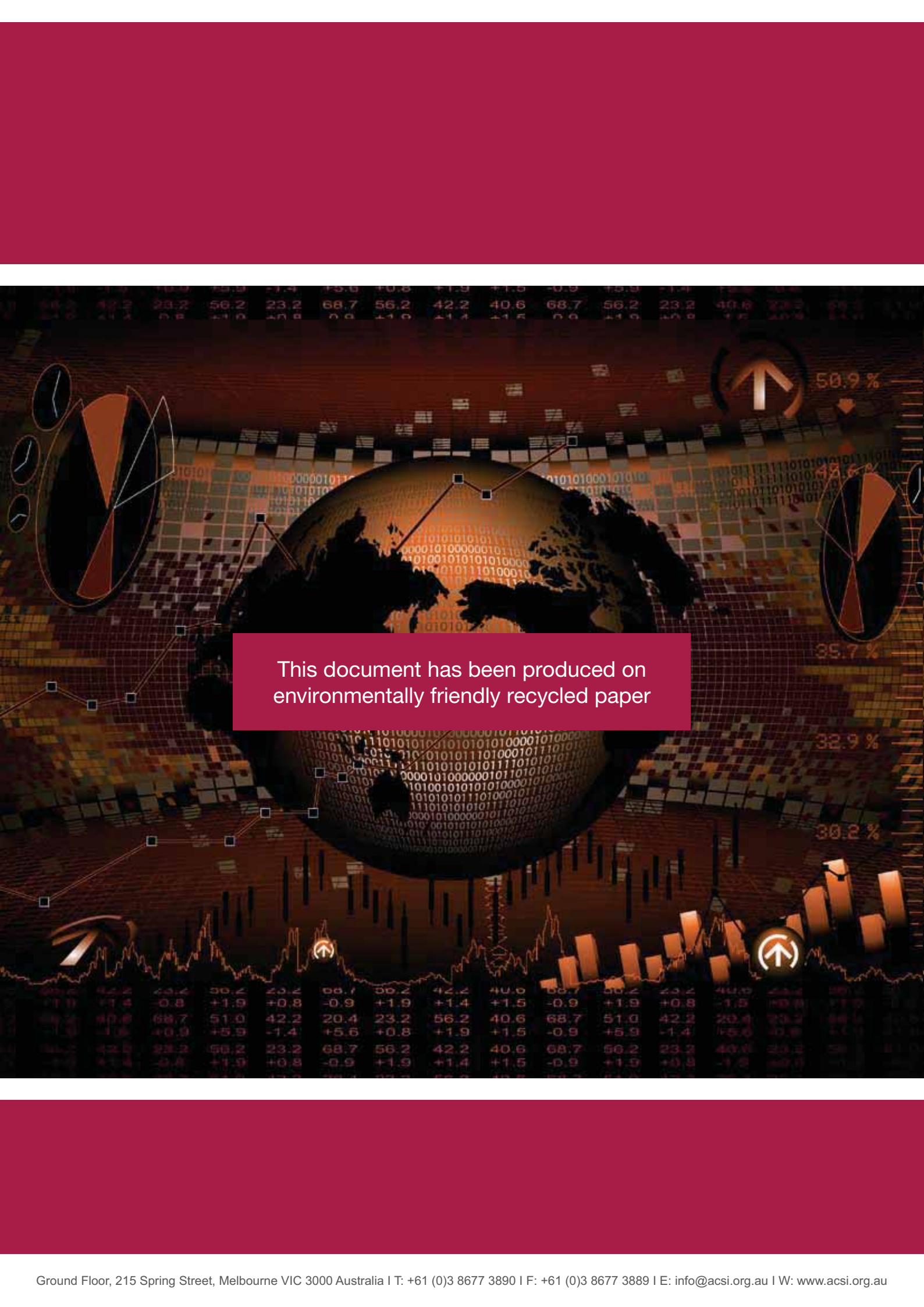
- (a) ACSI supports the auditor providing an annual statement that no circumstance has existed during the year that has affected the independence of the audit engagement team or audit firm. Where a perceived lack of independence exists, the auditor should outline the arrangements in place to ensure that the quality of the audit was not compromised.
- (b) This statement should be included in the financial reports of the company.

Part G. Acknowledgments

Any publication of this nature cannot be written and produced in isolation. The ACSI Committee of Management would like to acknowledge and thank the following people and organisations for their contribution to this revised edition of the Guidelines.

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