

Corporate governance

Reporting review August 2008



Welcome to Grant Thornton Australia's second annual review of corporate governance disclosure by the ASX 300.

In a period in which companies are under increasing pressure to perform, it is essential that they demonstrate to the market that they are managing their business effectively. They can do this by:

- Delivering a sustained record of good results;
- Demonstrating an effective strategy which is being effectively implemented; and
- Transparently disclosing the things they do to create an environment of strong corporate governance – to engender investor confidence.

While share market analysts frequently focus on the first two elements, the purpose of this report is to provide the reader with insight into what companies are doing about the third.

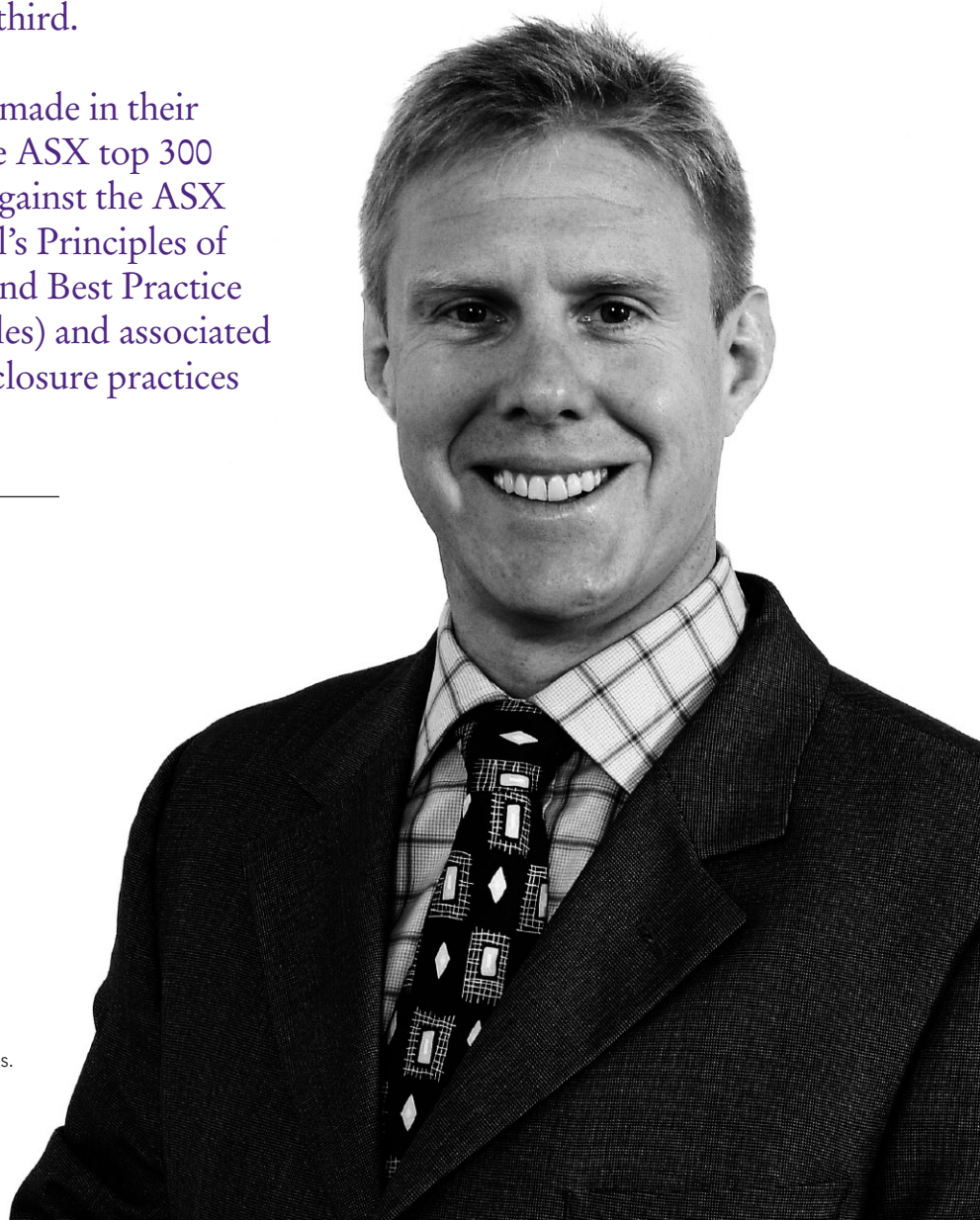
From review of the disclosures made in their 2007 annual reports*, 290 of the ASX top 300 companies have been assessed against the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations (the Principles) and associated guidance in order to profile disclosure practices and trends.

Matt Adam-Smith

National Head of Audit & Assurance Services
Grant Thornton Australia

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*Reports reviewed included those for financial year ending either 30 June 2007 or 31 December 2007 for the majority of companies.

Overview

This report summarises Grant Thornton Australia's review of corporate governance and related reporting by the top 300 ASX listed companies (ASX 300). It follows the inaugural report last year, reflects on progress made and considers corporate governance initiatives occurring elsewhere around the globe as well as the impact this could have on our own environment in Australia.

The review uses the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations as a standard against which the reporting of the ASX top 300 companies was measured. The revised principles issued in August 2007 are not reflected in findings as they apply for reporting periods beginning 1 January 2008. However these amendments are more in the way of refinements rather than any substantial change, and are considered in the "Review findings in context" section of this report.

The 10 principles that were in effect for the period covered by this review are:

Principle	Topic
Principle 1	Lay solid foundations for management and oversight Recognise and publish the respective roles and responsibilities of Board and management.
Principle 2	Structure the Board to add value Have a Board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.
Principle 3	Promote ethical and responsible decision-making Actively promote ethical and responsible decision-making.
Principle 4	Safeguard integrity in financial reporting Have a structure to independently verify and safeguard the integrity of the company's financial reporting.
Principle 5	Make timely and balanced disclosure Promote timely and balanced disclosure of all material matters concerning the company.
Principle 6	Respect the rights of shareholders Respect the rights of shareholders and facilitate the effective exercise of those rights.
Principle 7	Recognise and manage risk Establish a sound system of risk oversight and management and internal control.
Principle 8	Encourage enhanced performance Fairly review and actively encourage enhanced Board and management effectiveness.
Principle 9	Remunerate fairly and responsibly Ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to corporate and individual performance is defined.
Principle 10	Recognise the legitimate interests of stakeholders Recognise legal and other obligations to all legitimate stakeholders.

We also assessed the quality of reporting in respect of Corporate Social Responsibility to provide comment on how companies are responding to the gathering demand for information in this area.

Review findings

In this report, we have focussed on four main areas. Each of these areas relates to ways in which our reporting environment is evolving, flags interesting trends or issues for discussion, or highlights potential areas for future improvement:

1. General overview including principles with notable shifts between disclosures last year and this year
2. Ongoing disparity between the ASX 201-300 and their larger peers
3. Risk Management
4. Corporate Social Responsibility

The graph below illustrates at a glance the top line compliance in each of our segments with the various principles.

General overview and notable shifts between last year and this year

Our review identified that only 132 companies or 45% of the top 300 companies fully comply with all aspects of the principles and best practice recommendations. This is materially consistent with the previous year when 134 companies or 45% were fully compliant. Where the disclosure provided was unclear we have denoted that company as non-compliant.

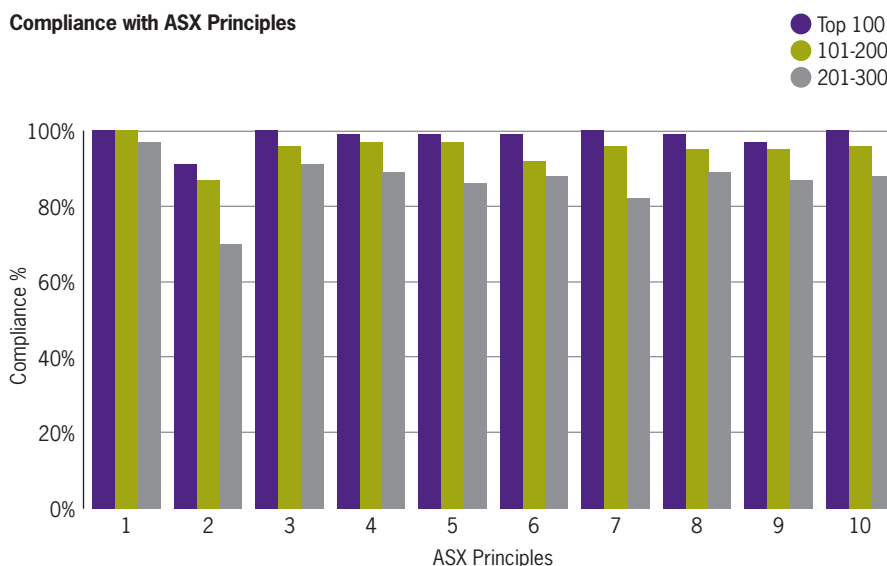
Areas of compliance improvement

Generally there was continuing improvement in most of the results since our review last year. Principles 4 (Safeguard Integrity of Financial

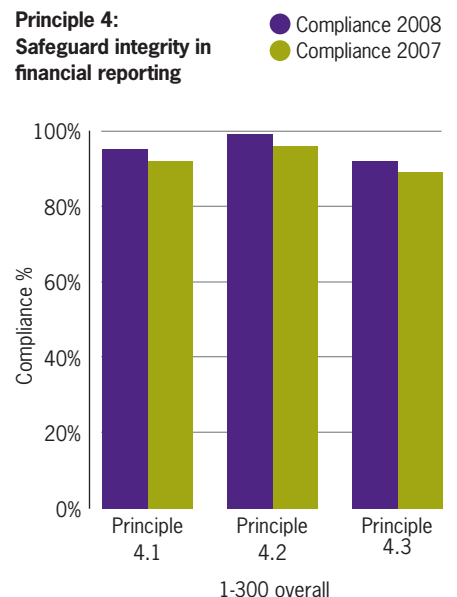
Reporting) and 7 (Risk Management – discussed in more detail separately) improved their average scores to be over 90% compliant.

Some of the sub-principles contained in Principle 4 saw statistically significant improvements in compliance of around 3%. There are a couple of possible explanations for this. Firstly, the increase may be viewed as a natural trend as companies come to terms with the recommendations. It may also be that listed companies perceive their financial reporting obligations as their highest priority and as such have dedicated more resources over the past year to improvement in this area.

Compliance with ASX Principles



Principle 4: Safeguard integrity in financial reporting



Principles that performed well but remained steady

Another principle that showed a high overall average for compliance was Principle 3 (Promoting Ethical and Responsible Decision Making), with the ASX top 100 scoring 99% or greater. Principle 3.1 (establish a code of conduct for guidance for directors and key executives) showed 96% compliance, and 3.2 (Disclose the Policy concerning Trading in Company Securities by Directors, Officers and Employees.) had 95% compliance for the ASX top 300, both the same as last year.

Principle 6.1 (Design and disclose a communications strategy to promote effective communication with shareholders) also remained consistent with last year's result with a 97% average for the ASX 300.

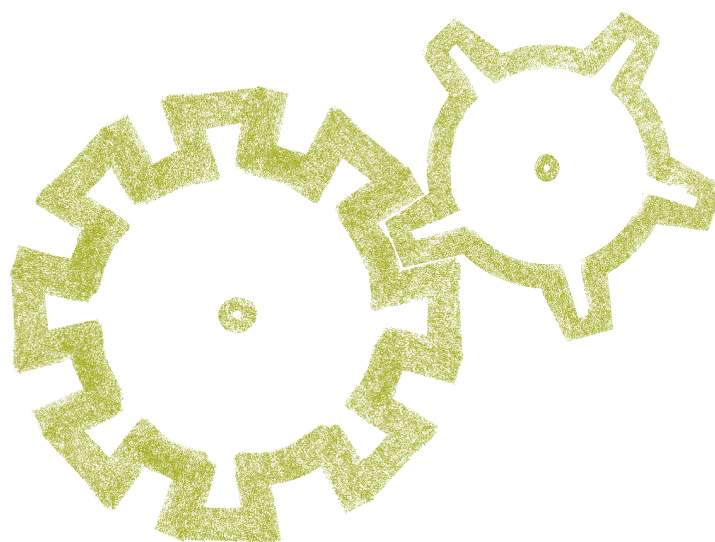
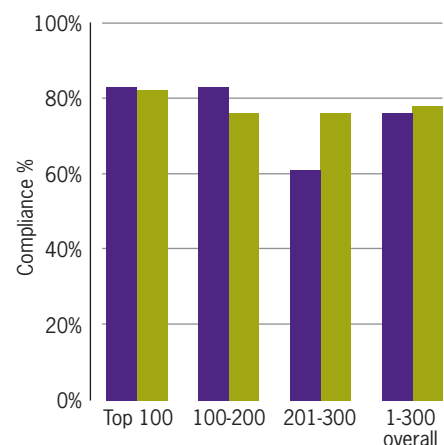
Areas of compliance decline

Of all the Principles, only Principle 2 (Structure the Board to Add Value) scored an overall average of less than 90% compliance. Principle 2, which relates to the structure of the Board and its independence, scored an average of 83% compared to 84% in the prior year. Principle 2 also includes a requirement to disclose certain information. For the 10% of companies that did not, there was an absence of any explanation for the omission under the "if not, why not" rules.

Perhaps more revealing, were some of the sub-principles that also saw decline. Principle 2.1 (A Majority of the Board should be Independent Directors) showed only 76% were compliant compared to 78% last year. Since the principles were first issued, there has been continued debate concerning the appropriateness of this recommendation (although the majority of governance standards issued around the world have this as a core requirement). This begs the question - where compliance levels are slipping, is it due to underlying dissent?

Given that generally, compliance levels have shown improvement, another possible explanation for decline is the introduction of new organisations to the ASX 300.

Principle 2.1 A majority of the Board should be Independent Directors



Disparity between the ASX 201-300 and ASX100

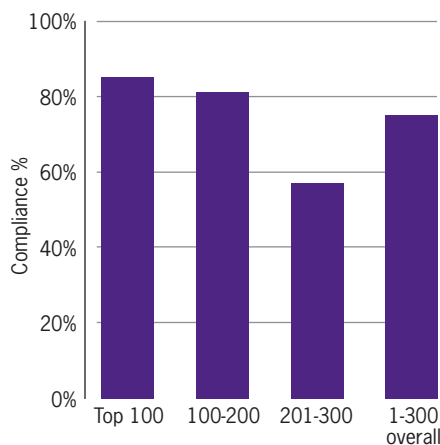
While the average results across the top ASX 300 companies were generally good, as might be expected, the ASX top 100 were consistently highest scoring overall. Many of the ASX 300 averages were impacted by materially lower rates of compliance in the companies comprising ASX 201 – 300 that, while not surprising, suggests more needs to be done to bring them up to the standards of their larger peers.

There are several examples in the review findings of averages being impacted by this disparity. Principle 2.2 (The Chairperson should be an Independent Director) shows an overall average of only 75% of the top 300 met this standard, which seems disappointing. But on closer inspection we see that the overall average has been negatively impacted by companies in ASX 201 – 300, ranked poorly at 57%.

Similar disparities are seen in Principle 4.1 (illustrated on previous page), 7.2 and 9.4 (defined and illustrated below) and in Principle 2.1, examined in the preceding section (where the difference in compliance between the

Principle 2.2

The Chairperson should be an Independent Director



top 100 and 201-300 was 22%), as well as areas relating to Corporate Social Responsibility (discussed separately).

While it is tempting to label these results as disappointing, it is not unexpected and appears to be based on issues of scale. In this regard, the “if not why not?” provisions can help us explain the disparity. Under Principle 2.4 - The Board should establish a Nomination Committee - overall

78% of the ASX 300 did not have a Nomination Committee, however 92% of the top 100 did. For most that did not, it was argued that their size did not justify a separate committee and that the Board fulfilled the role. For those companies that are smaller, this is a reasonable argument under the ‘if not, why not’ rules.

This example illustrates that the “if not why not?” provisions serve an important purpose. However as was flagged in last year’s review, overreliance on them can potentially damage governance practice and can ultimately have commercial implications. For example:

- Remuneration issues covered by Principle 9 have received considerable shareholder attention.
- Poor management of risk (Principle 7) at an operational level can result in reduced shareholder value.
- Those who don’t act ethically in regard to corporate social responsibility practices are potentially limiting their access to capital as shareholders demand a better response from the companies they invest in.

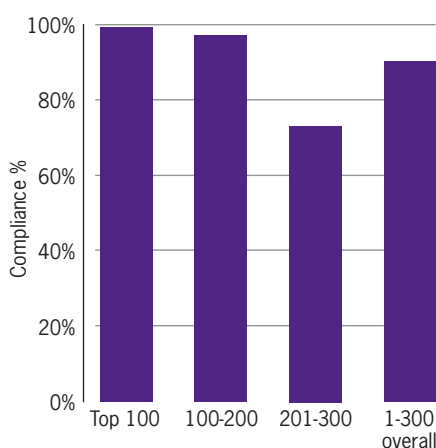
In each of these areas, lower compliance with the Corporate Governance Principles can potentially result in negative commercial ramifications. This could disadvantage smaller companies.

This then begs the question - what can be done to improve compliance levels in the ASX 201-300 segment? The new changes around Principle 7 (identifying and managing risk) may go some way to addressing this, as they encourage a shift of focus from financial risks, to include more strategic and operational risks which can also affect shareholder value. But more industry consideration certainly needs to be given to this issue as the figures show a clear gap that needs to be addressed.

Principle 7.2

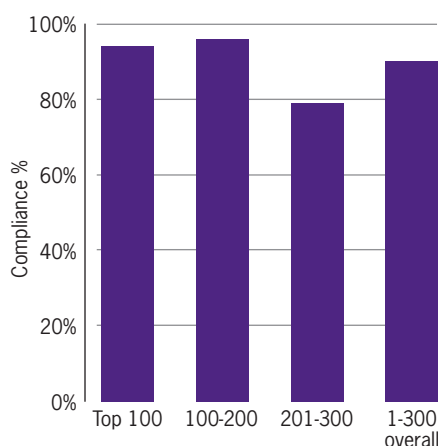
The Chief Executive Officer (or equivalent) and the Chief Financial Officer (or equivalent) should state to the Board in writing that:

- the statement given in accordance with best practice recommendation 4.1 (the integrity of financial statements) is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the Board; and
- the company’s risk management and internal compliance and control system is operating efficiently and effectively in all material respects



Principle 9.4

Ensure that payment of equity-based executive remuneration is made in accordance with thresholds set in plans approved by shareholders



Risk Management

The ASX top 300 was 98% compliant with Principle 7.1 - the Board should establish policies on risk oversight and management - up 2% on last year. This represents the continued acceptance and maturity of formal risk management as a discipline in Australian corporates and is encouraging.

However it is likely the disclosures do not tell the full story, with much work yet to be done in implementing sustainable risk management practices which are embraced by management. Some of the other statistics revealed under Principle 7 hint at this, with only 85% of the mid 200 companies providing information in respect of their risk management policy and internal compliance control systems under Principle 7.3.

This suggests a gap between the quality of the risk management processes

reported by companies and the level of maturity that has actually been achieved. While all of the foundation work has been done, including a general acceptance that risk management is necessary, defining risk measures, identifying risk and reporting it, there are still gaps that are preventing risk management from truly adding value and protecting shareholder value. For example, it is possible that many risk mitigation strategies being reported are 'aspirational' rather than real activities. This issue is not always detected by the Board because there are often no processes which provide assurance that the strategies are being implemented. Internal Audit can have a key role to play in this regard, by providing assurance to the Board of implementation.

Likewise, Principle 7.2, which involves management attestations regarding the quality of risk

management practices, including their impact on the reliability of financial reporting, found an average of only 90% compliance. This average was reduced significantly by the ASX 201-300 who were only 73% compliant. These results could be symptomatic of a number of issues rooted in a lack of sustainable systems that are supported by management.

As reflected by the lower figure for the ASX 201-300 discussed above, such systems are even less likely to gain support in smaller organisations with limited resources. In some companies risk management is seen by key managers as an additional administrative burden that they have to deal with. It may not yet have become part of the business planning process, so the risks relating to failure to implement are not being identified and managed in a structured manner.

“Risk management is not easy for a company to implement and maintain, yet it is a crucial element of good governance. The more directors create a ‘pull’ in the organisation for risk information, the more management will prioritise the risk process. Boards can achieve this by working with management to ensure there is a common view of risk and the things that should be done to manage it”

Peter Moloney

Director – Business Risk Services



Corporate Social Responsibility

Corporate Social Responsibility is no longer the domain of interest groups and those companies who choose to demonstrate their social conscience - it is becoming a necessity rather than a choice. Those businesses adopting ethical business practices quickly, efficiently and communicating their commitment to them through comprehensive disclosure, will survive. These are the businesses that will secure the skilled workers and the contracts with the large multinationals. Those failing to act now may face an uncertain future.

While Principle 7 covers Risk Management in some detail, Corporate Social Responsibility has less prescriptive guidance provided by Principle 10; which also deals with a number of other issues. It is also interesting to note that Principle 10 has been eliminated in the revised guidelines and elements of it subsumed into Principles 3 and 7. It could be argued that this reduces the prominence of the issue.

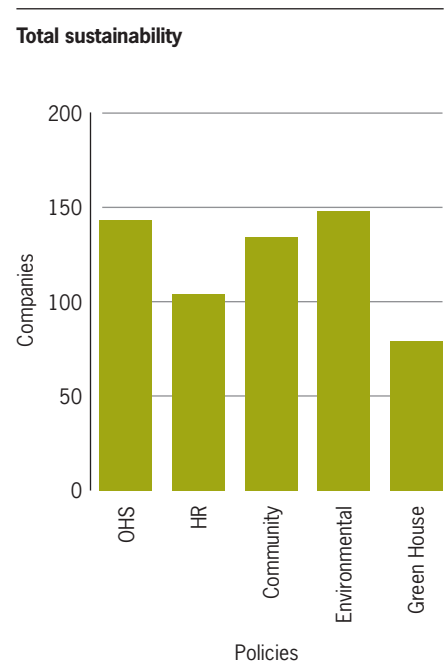
Notwithstanding this, many companies have recognised the demand by stakeholders for this information. Our review has assessed how well ASX companies are informing stakeholders regarding their progress in this crucial area.

We reviewed the existence of reporting against five key elements of Corporate Social Responsibility:

- Occupational Health & Safety (OH&S)
- Human Resources (HR)
- Community
- Environment
- Greenhouse

We did not rely on each company's annual report; rather we included information found in their web site and any sustainability reporting in our findings. The statistics are interesting and, while the absence of disclosure does not mean that companies are not addressing the issue, it does mean that they have not recognised a clear demand for this type of information. Our findings are summarised in the graph on the right.

Overall, the top 100 ASX companies performed far better in each of the areas reviewed than any other. While they may have greater resources, the demand for shareholder capital is real and those who do not maintain and disclose high social responsibility standards are limiting their access to capital as individual shareholders and purpose built funds alike demand a better response from the companies they invest in.



Greenhouse

This was the worst performing of all the sections; as well as the most critical and hardest. Only 28% of the top 300 ASX companies have provided information on policies or practices that have been undertaken to reduce greenhouse gases. Given the greenhouse reporting requirements that are now in place and the establishment of the Carbon Pollution Reduction Scheme in 2010, we would expect a significant improvement in disclosure for the 2008 reporting season. This information is becoming even more crucial to stakeholders because, now in addition to environmental considerations, the cost of doing business will have to be considered.

Environment

Any policy or practice that a company has in respect of the environment was considered in our assessment. Overall 52% of the top 300 ASX companies had publicised work that they had undertaken or policies that they had on environmental issues. This is the best result in the five areas reviewed.

Community

This relates to the activities that a company will undertake to assist the community. It is not as much about policies, but rather the actual work that has been undertaken. 47% of the top 300 ASX companies have publicised information about the community work that they undertake.

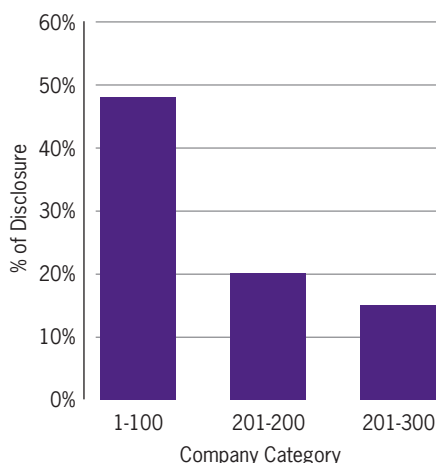
OH&S

50% of the top 300 ASX companies publish information that discloses information on their OH&S policy or procedures.

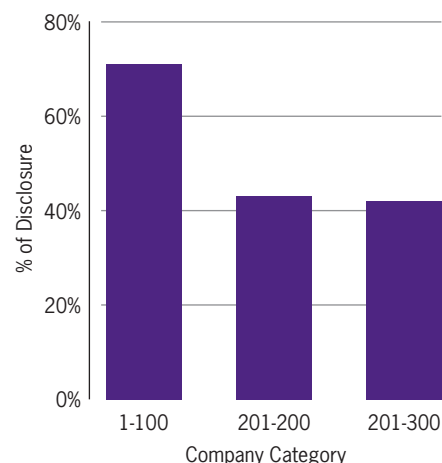
HR

Only 36% of the top 300 ASX companies publish information on their HR policies.

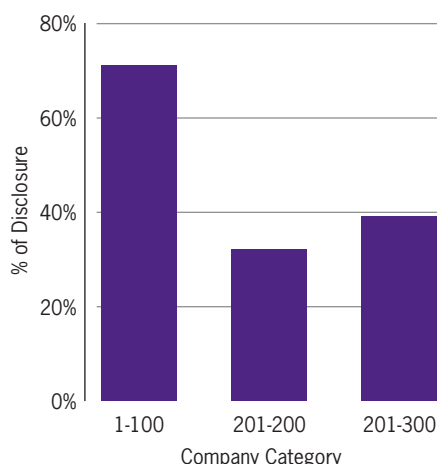
Disclosure of greenhouse policies



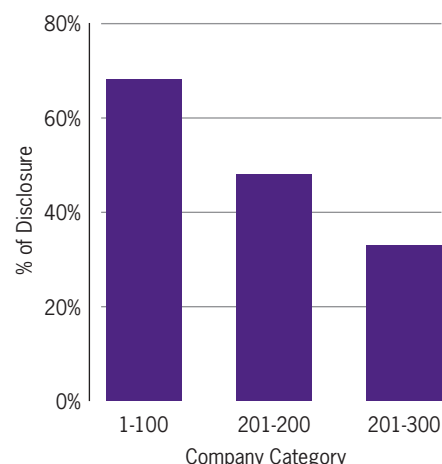
Disclosure of environmental work



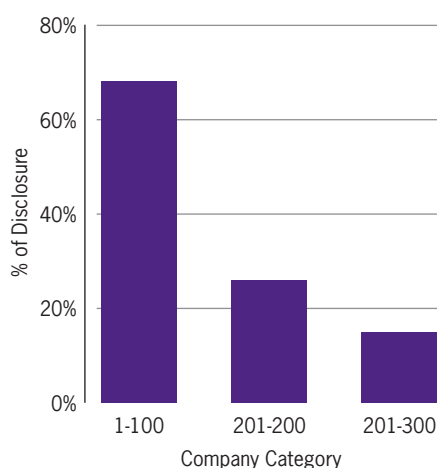
Disclosure of information regarding community work



OH&S policy disclosure



HR Policies



Review findings in context

The ASX quite rightly considers market disclosure as a cornerstone to improving corporate governance. The more transparent companies are about their corporate governance practices, the better placed investors will be to make informed decisions. In our experience, companies that have demonstrated strong corporate governance practices have a much better record of long term success than those who do not. Our survey has found that the smaller the company, the less is being done or disclosed in respect of the ten principles.

Below we consider the evolution of Corporate Governance around the globe, from the prescriptive rules based approach of the United States, to the principles-based approaches adopted elsewhere.

Australia

The ASX Corporate Governance Council has now amended the Principles for Good Corporate Governance and Best Practice recommendations, first released in 2003, reducing the number of principles from ten to eight. The new principles apply for reporting periods beginning 1 January 2008 so we should start seeing the results of these changes towards the end of the first quarter of 2009. These are now referred to as Corporate Governance Principles and Recommendations – any reference to ‘best practice’ has been removed.

The key changes are:

- The original principles eight and ten have been amalgamated into the remaining eight principles
- Principle 2: Structure the Board to add value now provides a list of relationships that could impair independence rather than providing a definition. In order to provide less latitude than may have been the case, companies are also required to disclose their reasons for defining a director as independent when one of the stated relationships exists

- Principle 7: Recognise and manage risk, builds on the earlier guidance by making it clear that material business risks can include both financial and non financial risks. The earlier principles and subsequent guidance suggested a focus on financial risks, which can now be rightly seen as part of a phased and manageable implementation of structured risk management for listed companies. We consider the change highly appropriate as failure to manage a material operational risk will inevitably result in lost shareholder value. The recommendation also addresses sustainability and corporate social responsibility by recommending that these risks, where they are material, also be considered.

There are also changes in respect to policies around hedging unvested options and the related disclosure as well as a revised version of the ‘sign off’ on financial reporting risks.

United Kingdom

Changes to the Combined Code

In June 2008 the Financial Reporting Council (FRC) published an update to the Combined Code. The two main changes were:

- to remove the restriction on an individual chairing more than one FTSE 100 company
- for listed companies outside the FTSE 350, to allow the company chairman to sit on the audit committee where he or she was considered independent on appointment.

The update of the Code took effect at the same time as new FSA Corporate Governance Rules implementing EU requirements, set out in the 4th and 8th Company law directives relating to corporate governance statements and audit committees.

The revised Code and new Rules will apply to accounting periods beginning on or after 29 June 2008. In practice this means that most companies will begin to apply them in 2009, and will report against them for the first time in 2010.

The relative lack of change is seen as a good indicator that the various stakeholders are getting what they want from the Code and that the “comply or explain” approach is working.

Companies Act 2006

The 1 October 2007 saw the next phase of the UK Companies Act changes come into force. In terms of corporate governance disclosure requirements, the most significant amendment was the requirement for the extended business review for full list companies to include:

- the main trends and factors likely to affect the future development, performance and position of the company’s business
- information about environmental matters (including the impact of the company’s business on the environment), the company’s employees, and social and community issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies
- information about persons with whom the company has contractual or other arrangements which are essential to the business of the company.

The Act also permits directors to omit information about impending developments or matters in the course of negotiation where the directors consider that disclosure would be seriously prejudicial to the interests of the company.

USA

Following the clamour for a more risk-based approach to corporate governance and Sarbanes-Oxley implementation, Auditing Standard No. 5 was released by the Public Company Accounting Oversight Board on 24 May 2007 and was approved by the U.S. Securities and Exchange Commission on 25 July 2007.

With this new Standard, US-listed companies can further streamline their compliance efforts and reduce the number of key controls to be tested. The new Standard thereby hopes to achieve the continuous benefit of the focus on corporate governance and controls while reducing compliance costs.

Elsewhere

In June 2006, the Japanese Diet approved a bill amending the Securities and Exchange Law of Japan (SEL) and other financial laws to create the Financial Instruments and Exchange Law (FIEL).

The new Japanese Law is said to be similar to the Sarbanes-Oxley Act (the “Act”) of the United States, and accordingly was named Japanese SOX (J-SOX). The Act was also primarily designed to restore investor confidence following well-publicized bankruptcies that brought chief executives, audit committees, and the independent auditors under heavy scrutiny.

This legislation has come to effect for Japanese-listed companies with fiscal year starting on or after 1 April 2008.

Appendix

Summary table of review statistical findings.

2008	% of compliance													
Principles	1.1	2.1	2.2	2.3	2.4	2.5	3.1	3.2	3.3	4.1	4.2	4.3	4.4	4.5
Top 100	100%	83%	85%	99%	92%	96%	99%	100%	100%	99%	100%	98%	100%	100%
Mid 101-200	100%	83%	81%	94%	82%	93%	97%	96%	95%	97%	100%	97%	97%	95%
201-300	97%	61%	57%	92%	60%	81%	93%	90%	90%	88%	98%	81%	90%	87%
300 Average	99%	76%	75%	95%	78%	90%	96%	95%	95%	95%	99%	92%	96%	94%

Principles	5.1	5.2	6.1	6.2	7.1	7.2	7.3	8.1	9.1	9.2	9.3	9.4	9.5	10.1
Top 100	99%	99%	100%	99%	100%	99%	100%	99%	99%	99%	100%	94%	95%	100%
Mid 101-200	98%	96%	96%	89%	97%	97%	94%	95%	97%	94%	98%	96%	93%	96%
201-300	90%	82%	94%	81%	96%	73%	76%	89%	89%	89%	87%	79%	81%	88%
300 Average	96%	93%	97%	90%	98%	90%	90%	94%	94%	94%	95%	90%	90%	95%

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