The alphabet soup of corporate governance reforms

Who is proposing what?

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Current initiatives in the US and Australia will lead to higher standards of corporate governance and disclosure being set for listed and unlisted public companies. Inevitably, some of the detail of the initiatives to raise corporate governance and disclosure standards has been lost in the media frenzy and the alphabet soup of review committees, inquiries, professional bodies and regulatory authorities focusing on this ‘hot’ issue. The purpose of this article is to:

- identify the stances of the major players in the debate
- briefly identify the nature of the reforms proposed by the Federal Government, the Joint Committee on Public Accounts and Audit, the Australian Stock Exchange Limited (ASX) and its Corporate Governance Council
- highlight some of the areas relating to disclosure upon which companies should focus their attention in anticipation of the proposed corporate governance reforms coming into effect in 2003.

The major players

Federal Government, CLERP 9 proposals

While Treasurer Peter Costello may have been torn between waiting for the HIH Royal Commission findings and being seen to respond urgently to Australia’s corporate scandals, he did release the Federal Government’s 41 policy proposals on audit regulation and corporate disclosure on 18 September 2002. This response, CLERP 9, is the latest chapter in its Corporate Law Economic Reform Program.

The Government’s stated intention is to reshape the financial reporting framework with a focus on the quality of financial reporting. With some five million Australians directly involved in the share market, and millions more indirectly exposed to it, many of the reform proposals seek to establish a culture in which directors will give primacy to the ethical pursuit of shareholders’ best interests.

Consultation with business and the community on the proposals closed on 22 November. The Government proposes to release exposure draft legislation for comment with legislation expected to be introduced in early 2003. However, Government action, particularly in the area of audit independence issues, will await the report of the HIH Royal Commission in February.

More than half of CLERP 9’s 200 pages are dedicated to the issues raised by Prof Ian Ramsay, Director of the Corporate Law Centre at Melbourne University, in his report on the independence of auditors. This article will focus on issues relating to disclosure, not on issues of audit reform.

Joint Committee on Public Accounts and Audit

On the same day as CLERP 9 was released, the Joint Standing Committee on Public Accounts and Audit released its Report 391 ‘Review of Independent Auditing by Registered Company Auditors’. The report proposes to provide a framework enabling a broadening of the scope of the audit function to include, for example, corporate governance, risk management, internal control issues or other performance type issues.

Predictably, the substance of many of the report’s recommendations are similar to those contained in the CLERP 9 paper, eg, the call for...
listed public companies to have an independent audit committee and the recommendation that a framework for protected (or whistleblower) disclosure be established in the Corporations Act 2001.

ASX’s Exposure Draft

The ASX paper on Enhanced Disclosure, issued on 19 July 2002, proposes a number of changes to both the continuous and periodic financial disclosure regimes designed to enhance the provision of timely and relevant information for the benefit of all investors. ASX believes a successful continuous disclosure system requires the creation of a ‘culture of disclosure’, as distinct from a ‘culture of compliance’. In actively promoting a culture of disclosure, ASX seeks to pre-empt the need for enforcement.

The ASX continuous disclosure reform proposals have been endorsed by CLERP 9. The listing rule amendments, some of which are discussed below, are proposed to take effect on 1 January 2003.

Corporate Governance Council

The current ASX policy of not obliging companies to adopt particular corporate governance practices has been criticised by the Federal Government and business. ASX has responded by establishing a Corporate Governance Council to develop best practice standards of corporate governance for listed companies.

Membership of the Council is a veritable who’s who of Australian business, which includes amongst its members representatives of Chartered Secretaries Australia, the Association of Superannuation Funds of Australia, Australian Institute of Company Directors, Australian Shareholders’ Association, Business Council of Australia, CPA Australia, Investment and Financial Services Association, Law Council of Australia, Property Council of Australia and Securities Institute of Australia.

In its first public statement, issued on 15 August, the Council urged listed companies to adopt its recommendations. Compliance with the rules remains ‘voluntary’. Companies are urged to:

- establish audit committees (at least by the top 500 listed companies that compose the All Ordinaries Index)
- disclose share and option schemes including details of performance hurdles
- disclose total fees paid to external auditors including a breakdown of fees for non-audit services
- include meaningful management discussion and analysis in financial reports
- disclose capitalisation policies and practices including the circumstances in which costs are capitalised against future income streams
- disclose the extent of any contractual arrangements they have entered into, such as leases, which carry financial obligations for future years
- disclose the measures they have in place to ensure provision of equal access to material information through the continuous disclosure regime.

In its second statement released on 19 September, the Council strongly endorsed the Government’s continued support for a principles-based approach to address corporate governance issues. The Council considered that a mix of regulation, co-regulation and encouragement of industry best practice produces the most effective environment to encourage continual innovation and a culture of best practice.

By March 2003, the Council intends to endorse and release guidelines developed by working groups on various complex corporate governance issues under discussion and release an updated ASX Corporate Governance Guidance Note. Issues to be dealt with by the working groups will include:

- board composition and independence of directors
- competency of directors
- remuneration
- related party transactions
- integrity of reporting, including consideration of audit committees
- risk management and codes of ethics for senior management
- shareholder participation.

Disclosure reform highlights

As one commentator has observed, ‘it would require the passion of a full-time regulation tragic, or the mind of a Barry Jones, to go through the acronym soup of committees, inquiries, professional bodies and regulatory authorities engaged on the matter’. Similarly, it would require the passion of a regulation tragic to go through all of the reforms proposed by these bodies. However, many of the reforms floating to the top of this acronym soup focus on the two areas most affected by the US and Australian crises — auditor independence and disclosure. With this in mind, it may be useful to highlight some of the proposals relating to the area of disclosure upon which companies should focus their attention in anticipation of the proposed reforms coming into effect in 2003.

Disclosure of corporate governance practices

The ASX Corporate Governance Council has proposed retaining the ASX requirement that companies report on their main corporate governance practices in the annual report, and to do so by reference to the corporate governance principles to be set by the ASX Corporate Governance Council.
companies do not follow the best practice recommendations of the Council, they must identify where they do not and explain why.

The Joint Committee on Public Accounts and Audit has recommended that the Financial Reporting Council (which currently oversees the accounting standard setting process):

- develop a set of corporate governance standards, including prescriptions for internal audit, taking primary guidance from the findings of ASX’s Corporate Governance Council
- take all steps to ensure these standards be given legislative backing in the Corporations Act 2001.

The Committee has also recommended that ASX amend the Listing Rules to require additional reporting by companies in the following areas:

- commentary on internal control systems, including risk management processes
- management discussion and analysis
- commentary on the main factors affecting reported financial performance and financial position
- commentary on the key judgments made in the application of accounting policies
- results for a set of key performance indicators pointing out the health of the organisation
- details of directors’ and executives’ performance appraisal or management systems.

Companies can expect further guidance on these issues when the Corporate Governance Council releases its guidelines on corporate governance practices and its revised ASX Corporate Governance Guidance Note in the first half of 2003.

**Dissemination of price sensitive information**

As part of the CLERP 9 proposals, the Government has stated it will maintain and enhance the framework of continuous disclosure. In particular, it has stated that all investors should have access to materially price sensitive information disclosed by listed entities. If it is a key characteristic of an effective continuous disclosure regime that all investors have access to materially price sensitive information on an equal basis, so that particular market participants are not disadvantaged in relation to others, then perhaps the regime in Australia is not working so effectively.

By the Government’s own admission, the current procedures for the dissemination of price sensitive information released by listed companies appear to disadvantage small investors in comparison with market participants and institutional investors. One option to redress this situation would be for ASX to make price sensitive information immediately available to all investors. Alternatively, listed companies are encouraged to:

- establish web sites and post materially price sensitive information at the same time that this information is first released by ASX
- provide facilities for investors to be electronically alerted to the existence of new postings through real time electronic messaging systems such as e-mail or SMS.

**Externally generated speculation**

Another of the CLERP 9 proposals states that market operators, eg, ASX, should require listed entities to respond to externally generated speculation in circumstances where the operator determines that this is having a significant impact on the market for their securities. As previously noted, ASX, in its Enhanced Disclosure Exposure Draft, proposed amendments to the Listing Rules to further enhance the continuous disclosure regime.

One of the amendments to ASX Listing Rule 3.1 is intended to enable ASX to determine that information is no longer confidential and must therefore be disclosed to ASX. A failure of a listed company to release information that is no longer confidential, either because it was leaked or is the subject of an externally generated rumour that is sufficiently accurate that it cannot be regarded as confidential, may amount to a contravention of this Listing Rule and potentially s 674(2) of the Corporations Act 2001. It is salutary to note that another of the CLERP 9 proposals aims to increase the maximum civil penalty for a contravention of the continuous disclosure provisions by a body corporate from $200,000 to $1 million.
A second amendment to ASX Listing Rule 3.1 proposes to require listed entities to deny false rumours in certain circumstances. Where there is rumour circulating or media speculation which is reasonably specific and credible and it has not been the subject of an announcement to the market, and the rumour or speculation appears to be having an impact on the share price or would seem likely to do so, a clarifying announcement must be made by the company to the market for the benefit of all investors.

The second amendment will be effected by adding a fourth limb to the current carve-out that allows listed entities to withhold materially price sensitive information from disclosure in certain circumstances. This amendment would provide that entities could only withhold this information if ASX has not asked the entity to provide it with information to prevent a false market in its securities.

Review of internal compliance

The due date for comments on the Enhanced Disclosure Exposure Draft was 16 September and at the date of writing the final form of the proposals had not been released. However, in anticipation of the amendments to Listing Rule 3.1 coming into effect in early 2003 substantially in the proposed form, it would be prudent for companies to review their internal compliance measures in an effort to minimise the likelihood of inadequate disclosure in the future. In particular, continuous disclosure policies and practices should be reviewed to take into account:

- when information is confidential, ie, if it is only in the possession of persons who have a legitimate interest in it and exert control over its dissemination and who acknowledge that they are not able to trade in securities of the entity until that information is released to the market
- when information is no longer confidential, ie, it is released by the entity either selectively or generally, whether inadvertently or deliberately, and where it is not released by the entity, but becomes available from other sources
- when ASX would consider that there is a false market in the entity’s securities, ie,
  (a) the entity has information that has not been released to the market because of the carve-outs in the proposed Listing Rule 3.1A and
  (b) there is reasonably specific rumour or media comment in relation to the entity that has not been confirmed or clarified by an announcement by the entity to the market and
  (c) there is evidence the rumour or comment is having, or ASX forms the view that the rumour or comment is likely to have, an impact on the price of the entity’s securities.

It is also proposed that the commentary in Listing Rule 3.1, on what information requires disclosure if material under that rule, will be amended to include changes in accounting treatment and credit ratings.

In respect of periodic disclosure, ASX has proposed a reduction in lodgment time for periodic reports to 60 days after the end of the reporting period. While the current 75–day period is, according to ASX, best practice in global terms, ASX believes Australia has a strategic imperative to remain at the forefront of best practice.

While Australia may be ahead of the US when it comes to some aspects of disclosure law, the former head of the Australian Securities and Investments Commission, Alan Cameron, keenly observed that it is a ‘question of whether they can be seen to be falling behind’ after the introduction of the tough new Sarbanes-Oxley Act 2002 in the US.

Today’s mantra

In general terms, many of the proposals put forward by the alphabet soup of review committees incorporate measures which aim to allow shareholders to more easily monitor the performance of companies and directors in order to reduce instances of lax and unethical behaviour. Where previously the mantra was efficiency and profitability, the mantra today is accountability, integrity and transparency.

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