A Guide to Understanding Corporate Governance

CORPORATE GOVERNANCE

Corporate governance is a system developed by the management of an organisation that effectively manages relationships with both external and internal parties with integrity to produce enhanced organisational performance.

It is relevant to all companies - public or private sector organisations, or profit or not for profit organisations.

NEED FOR CORPORATE GOVERNANCE

Good corporate governance is required by Australian companies to ensure access to global capital markets and to reduce the cost of capital to that company.

Good corporate governance practices help companies maintain a competitive edge both within Australia and overseas, and help improve investor confidence.

IMPORTANCE OF CORPORATE GOVERNANCE

Implementation of a corporate governance structure within an organisation encourages management of the organisation to create additional value for the stakeholders of the organisation (including shareholders, employees, suppliers) and provides a structure that manages the risk of the organisation effectively.

This value could be created via growth in the share price, increase profitability, while at the same time attempting to insulate the organisation from significant risk.

EFFECTIVENESS OF CORPORATE GOVERNANCE

Implementation of a corporate governance structure by an organisation will not guarantee the success of an organisation. Nor will it guarantee the prevention of an organisation of failure or bad decision making.

Corporate governance will only work if the culture of an organisation embraces the good corporate governance it has adopted. This means all employees of the organisation have to understand and abide by these principles - from the directors and senior management of the company, to part time or casual staff.

ATTRIBUTES OF GOOD CORPORATE GOVERNANCE

The governance adopted by the organisation will depend on the size and structure of the organisation. There's no hard and fast rule that can be applied to all organisations. For example, the internal control systems of a large organisation would be more complex than a small family business.

The attributes of good corporate governance should mirror the core principles or best practice recommendations published by the ASX Corporate Governance Council. These 10 principles were developed for companies listed on the Australian Stock Exchange. However any organisation looking to implement good corporate governance could consider these principles.

ASX CORPORATE GOVERNANCE COUNCIL PRINCIPLES[1]

1. **Lay solid foundations for management and oversight**
   Recognise and publish the respective roles and responsibilities of Board and management.

2. **Structure the Board to add value**
   Have a Board of an effective composition, size and commitment to adequately discharge its responsibilities and duties. For example a majority of the board should be independent.

3. **Promote ethical and responsible decision making**
   Actively promote ethical and responsible decision-making. For example establish a code of conduct for directors and key executives to ensure someone is responsible and accountable for reporting and investigating reports of unethical behaviour.

4. **Safeguard integrity in financial reporting**
   Have a structure to independently verify and safeguard the integrity of the company's financial reporting. For example the Board should establish an audit committee.

5. **Make timely and balanced disclosure**
   Promote timely and balanced disclosure of all material matters concerning the company.

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6. **Respect the rights of shareholders**
   Respect the rights of shareholders and facilitate the effective exercise of those rights. For example design and disclose a communications strategy to promote effective communication with shareholders and encourage effective participation at general meetings.

7. **Recognise and manage risk**
   Establish a sound system of risk oversight and management and internal control.

8. **Encourage enhanced performance**
   Fairly review and actively encourage enhanced Board and management effectiveness.

9. **Remunerate fairly and responsibly**
   Ensure the level and composition of remuneration is sufficient and reasonable and that its relationship to corporate and individual performance is defined. For example establish a remuneration committee.

10. **Recognise the legitimate interests of stakeholders**
    Recognise legal and other obligations to all legitimate stakeholders.

REPORTING CORPORATE GOVERNANCE

The location in which disclosures are required by listed companies range from principle to principle. The location varies between the following:

- Corporate Governance section of the annual report
- Company's website
- Where the company does not have a website, information must be made publicly available by other means for example post, or email.

The 'Corporate Governance Statement' will also provide disclosure of instances of non-compliance with the best practice recommendations of the ASX Corporate Governance Council providing reasons for non-compliance.

Small listed companies for example, due to their size may only have a small number of directors. This usually means the Board will not comprise a majority of non executive directors as recommended by the ASX Corporate Governance Council. This will be disclosed in the Corporate Governance Statement and the reasons why will be explained.

For further information and services relating to corporate governance go to:

http://www.cpaaustralia.com.au/links?corporategovernance

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[1]ASX Corporate Governance Council. "Principles of Good Corporate Governance and Best Practice Recommendations. Australian Stock Exchange. March 2003.

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