

**REVIEW OF CORPORATE GOVERNANCE DISCLOSURE
BY SELECTED ISSUERS**

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TERMS

Board	the governing body of an entity, whatever called, including councils and local authorities.
Entity	any entity operating under a governing board that is accountable to investors and/or stakeholders. It includes companies registered under the Companies Act 1993, all issuers of securities, unit trusts and other collective investment schemes, and state-owned enterprises, as well as many statutory bodies in the public sector.
Executive	employees of an entity who report to the board of the entity or to the Chief Executive Officer (CEO).
Executive director	a director who is an employee of the entity.
Independent director	a director who is not an employee of the entity and who does not represent a substantial shareholder and who has no other direct or indirect interest or relationship that could reasonably influence their judgement and decision making as a director.
Issuer	any entity that has issued securities to the public. Issuers include some statutory bodies in the public sector that issue securities.
Listed issuer	an entity with securities quoted on New Zealand Exchange Limited.
Non-executive director	a director who is not an employee of the entity.
Publicly owned entity	any entity that has shareholders (as defined below) that are members of the public. This includes companies and collective investment schemes that are widely held.
Shareholder	a person who owns shares in a listed or unlisted company, or a person who owns an interest in a collective investment scheme where they have rights, similar to those of a shareholder in a company, to participate in the assets of the entity on winding up and to vote on some issues regarding the entity.
Stakeholder	in relation to an entity, any person or group other than shareholders that is affected by the affairs of the entity.

EXECUTIVE SUMMARY

Assessing the strength of corporate governance in an entity is an important element of investment decision making. Investors rely on robust corporate governance to ensure that an entity is managed competently with their interests to the fore, and that the disclosures upon which they judge the current and potential performance of their investments are accurate and timely.

For entities that require investment, good governance is good business. Good governance not only provides entities access to a wider range of capital, but investors are also willing to pay a premium for shares in a well-governed company.¹

To reap these benefits, entities not only need to be well governed, but be *seen* to be well governed. These benefits also come to the fore in recessionary times where investors are seeking out entities that signal good governance. Disclosure of corporate governance policies and procedures is one way entities can demonstrate the strength of its governance to investors and other stakeholders.

This report presents the findings of the Securities Commission's latest review of corporate governance reporting. The purpose of this report is to inform governing bodies of our findings so that they can reflect critically on their governance practices and disclosures. In so doing, we aim to promote high standards of corporate governance by issuers and ultimately improve confidence in New Zealand's capital markets.

This review is of corporate governance disclosures by selected issuers, not of their actual behaviour. Corporate governance disclosures are an important indicator of the emphasis placed on corporate governance by a board, but investors and other stakeholders should not take this as a guarantee of good governance in practice.

The review analysed annual report and website disclosures of 68 selected issuers² against the Commission's nine Principles, which cover the core elements of good corporate governance.³

¹ McKinsey & Company (2000). *Investor Opinion Survey on Corporate Governance*. McKinsey & Company. http://www.mckinseyquarterly.com/Three_surveys_on_corporate_governance_965# (accessed May 3, 2010).

² A list of issuers reviewed is included in Appendix 2.

³ The Principles are set out in Appendix 1. In addition a Corporate Governance Handbook for Directors, Executives and Advisers, published by the Commission in 2004 is available on the Commission's website www.seccom.govt.nz. The Commission recognizes that regulatory thinking about corporate governance has developed since the 2004 Principles and Guidelines; and that the Principles will need to be considered for review by the Financial Markets Authority once it is established. In the meanwhile, reference is made elsewhere in this Report to some of the source material reflecting these developments in order to assist issuers in advancing their own thinking.

Overall findings

Many issuers provide transparent and relevant disclosures on their corporate governance policies, procedures and practices. Many issuers disclose clear and comprehensive information on:

- Principle 2: The independence, expertise and experience of board members;
- Principle 3: The use of board committees, such as remuneration and audit committees;
- Principle 5: Directors' and executives' remuneration, including use of remuneration policies and committees;
- Principle 6: Risk management policies and practices; and
- Principle 7: Processes for ensuring the quality and independence of external auditors, such as audit committees and auditor independence policies.

Issuers should improve disclosures on:

- Principle 1: Observing and fostering high ethical standards, e.g. through compliance with a code of ethics;
- Principle 4: Ensuring any standing corporate governance documents are readily available to interested investors and stakeholders, e.g. via the entity's website;
- Principle 5: Disclosure of how remuneration incentives are aligned with the issuer's objectives and risk management policies;
- Principle 6: Applying risk management policies to an issuer's material business and environmental risks e.g. by disclosing a risk matrix;
- Principle 8: Building constructive relationships with shareholders e.g. by disclosing market disclosure and communications policies; and
- Principle 9: Considering and respecting stakeholders' interests, e.g. by disclosing stakeholder relations policies and other social and environmental matters.

The Commission notes that adopting its Principles as a format for reporting can enhance the clarity of disclosures, as illustrated by The Warehouse Group Limited's 2008 annual report.

The Commission has written to issuers where it considers that their disclosures can be improved. We appreciate issuers' efforts to promote good governance in New Zealand, as demonstrated by their co-operative and positive responses relating to our correspondence.

Findings by entity type

In general, publicly owned entities publish significantly more governance information than closely held entities. In particular, some subsidiaries of overseas listed entities and finance companies provide little or no corporate governance disclosures. The Commission expects these issuers to improve their disclosures.

Promoting good governance in New Zealand

There is still scope for New Zealand issuers to improve their corporate governance policies, practices and disclosures. In particular, we recommend that entities reconsider their disclosures in relation to ethical standards, remuneration, risk management, shareholder relations and stakeholder interests.

Corporate governance best practice continues to evolve internationally. The global financial crisis highlighted deficiencies in remuneration and risk management policies, particularly in financial institutions.⁴ Similarly, many New Zealand finance companies lacked the appropriate risk and remuneration policies, procedures and practices required for the high-risk nature of the industry.

Entities must not only stay informed of recent developments in corporate governance best practice, but appropriately implement such developments in their organisations. For example entities should consider whether it is appropriate to separate their risk management and audit committee functions.⁵

The Commission will continue to review the corporate governance disclosures of issuers as part of its Corporate Governance Review Programme.

⁴ Walker, David, 2009, November 26. *A review of corporate governance in UK banks and other financial industry entities – Final recommendations*. Available URL: http://www.hm-treasury.gov.uk/walker_review_information.htm.

⁵ For further discussion on this matter refer to the discussion on Principle 3 in the Findings by Principle section of this report.

INTRODUCTION

1. Recently, the Securities Commission recommenced its reviews of issuers' corporate governance disclosures. Selected issuers' disclosures are reviewed against the Securities Commission's Corporate Governance Principles (the Principles) and Guidelines (the Guidelines).⁶
2. The purpose of this report is to inform governing bodies, investors and other stakeholders of our findings so that they can reflect critically on the governance practices and disclosures of issuers. In so doing, we aim to promote high standards of corporate governance by issuers and ultimately improve confidence in New Zealand's capital markets.
3. We emphasise that this review is of corporate governance disclosures by selected issuers, not of their actual behaviour. Comprehensive corporate governance disclosures are an important indicator of the emphasis placed on corporate governance by a board, but investors and other stakeholders should not take this as a guarantee that that emphasis is reflected in practice.
4. This report begins by outlining the background and format of our reviews and summarises the overall findings. The findings per Principle and recommendations for issuers are discussed later in this report.

BACKGROUND

5. In response to a number of high profile corporate collapses the Commission published its Principles and Guidelines in 2004. The Principles are high level objectives which all entities should aim to achieve in each area of corporate governance. A full list of the Principles is included in **Appendix 1**.⁷
6. The Principles recognise that entities take different approaches to achieving good governance according to their nature, ownership structure and stakeholders' interests. As such, the Guidelines do not represent rules for governance. Instead, their purpose is to assist entities in evaluating the effectiveness of their corporate governance procedures in relation to each Principle.
7. The Commission recommends that issuers report annually to investors on how the entity is implementing the Principles and explain any significant departure

⁶ The reviews are performed pursuant to section 10(c) of the Securities Act "to keep under review practices relating to securities, and to comment thereon to any appropriate body."

⁷ Further background to the Principles and Guidelines are available online at www.seccom.govt.nz and copies of the Commission's publication *Corporate Governance in New Zealand Principles and Guidelines: A Handbook for Directors, Executives and Advisers* can be requested free of charge.

from the Guidelines supporting each Principle.⁸ The Commission's Corporate Governance Review Programme (CGRP) reviews issuers' corporate governance disclosures in their annual reports and on their websites, against the Principles and Guidelines.

8. Our reviews focus on the disclosures each issuer has made on how they have achieved each of the Principles.
9. We have written to issuers where we consider that their disclosures are unclear or could otherwise be improved, making recommendations on further disclosure where appropriate.⁹
10. The Commission previously reviewed the corporate governance disclosures of listed issuers in their 2004 and 2005 annual reports. The Commission's comments on the 2005 review are available on the Commission's website.¹⁰ The current review also assessed issuers' website disclosures as they are increasingly used for corporate governance reporting. As a result, the current review is not strictly comparable to prior reviews. However, given that significant use of website disclosure is a more recent practice, we consider that comparisons do provide some insight into developments in corporate governance disclosures.

Sample selection

11. The Commission reviewed the disclosures of 68 issuers with balance dates ranging from 30 June 2008 to 30 June 2009. Of these:
 - (a) 57 had securities listed on a registered exchange¹¹ and two had securities quoted on the trading exchange *Unlisted*.
 - (b) 53 were publicly owned entities and 15 entities were closely held.
 - (c) The 15 closely held entities included a registered bank and 10 finance companies, six of which were operating under moratorium agreements.
12. A full list of the issuers reviewed is included in **Appendix 2**.

⁸ Guideline 4.7.

⁹ While the Principles are not legally enforceable, the Commission strongly recommends that issuers consider and take action on our recommendations. The Commission does not require issuers to reply to our letters on any matters we raise.

¹⁰ Chen, M and Cotton, A. *Securities Commission Principles of Corporate Governance – Update* (2006). The New Zealand Securities Commission. <http://www.seccom.govt.nz/speeches/2006/governance-principles-update>.

¹¹ Either NZX, NZAX, or NZDX.

OVERALL FINDINGS

13. Most issuers disclosed some information relating to each Principle. The most common disclosures, of which 74-88% of issuers reviewed reported on, are:
 - Principle 2: The independence, expertise and experience of board members;
 - Principle 3: The use of board committees, such as remuneration and audit committees;
 - Principle 5: Directors' and executives' remuneration, including use of remuneration policies and committees;
 - Principle 6: Risk management policies and practices; and
 - Principle 7: Processes for ensuring the quality and independence of external auditors, such as audit committees and auditor independence policies.
14. We consider that these findings are an improvement on the 2005 reviews. In the latest reviews, the quality of corporate governance disclosures varies and we therefore discuss good practice examples in the Findings by Principle section of this report.
15. Consistent with our 2005 reviews, the Principles least reported on are:
 - (a) Principle 1: Observing and fostering high ethical standards, such as compliance with a code of ethics;
 - (b) Principle 8: Building constructive relationships with shareholders, e.g. establishing market disclosure, communications and continuous disclosure policies; and
 - (c) Principle 9: Considering and respecting stakeholders' interests, including stakeholder relations policies and other social and environmental disclosures.
16. Approximately 70% of issuers report information on Principle 1, 50% on Principle 8 and 40% on Principle 9. The Findings by Principle section further discusses these findings and makes recommendations on how issuers could better meet the Principles.
17. Publishing standing governance documents online is a simple means for issuers to improve their corporate governance reporting. Despite the majority of issuers referring to having a code of ethics, committee charters and remuneration or risk management policies, less than half of issuers make these documents publicly available.
18. Some issuers publish their standing documents as part of a corporate governance manual. For example, Property for Industry Limited's Corporate Governance Manual incorporates how it meets the Principles and the NZX Corporate

Governance Best Practice Code. This manual is published on Property for Industry Limited's website.

Good disclosers

19. Many issuers provide good corporate governance disclosures, notably The Warehouse Group Limited, Auckland International Airport Limited and Fisher & Paykel Healthcare Limited. The quality of these disclosures is high, clearly addressing all of the Principles and reflecting their nature, size and operations. The Commission recommends all entities tailor their corporate governance disclosures to fairly reflect their corporate governance policies, procedures and practices.
20. Some issuers adopt the Securities Commission's Principles or other corporate governance principles and guidelines, such as those established by NZX Limited (NZX) or ASX Limited (ASX). For example, The Warehouse Group Limited has adopted the Commission's Principles as a format for reporting. This adds clarity to the disclosures in its annual report. Other entities may wish to follow this example.

Poor disclosers

21. Publicly owned entities generally provide more comprehensive disclosures than closely held entities. Several closely held entities provide little or no additional disclosures to the minimum statutory requirements.¹² The closely held finance companies' disclosures were poor. The Commission previously highlighted the importance of evaluating the governance structures and disclosures of finance companies.¹³
22. Several debt issuers that are subsidiaries of publicly owned entities provide limited or no corporate governance disclosures. In several cases, the parent entity provides detailed corporate governance disclosures in its annual report and on its website. However, these disclosures do not refer to any governance structures in operation at the subsidiary level. As a minimum, these issuers should include statements as to whether its parent's corporate governance policies and structures are implemented at the subsidiary level.
23. The Commission expects these issuers to improve their disclosures.
24. The Commission encourages investors and other stakeholders to consider the extent and quality of disclosures when evaluating an entity's corporate

¹² The statutory requirements include the requirements in Section 211 of the Companies Act 1993, Section 11 of the Financial Reporting Act 1993 and Part 2 Subpart 1 of the Securities Markets Act 1988.

¹³ The Securities Commission, 2006, August 22. *Finance companies – an option for investors who understand the risk*. Available URL: <http://www.seccom.govt.nz/new/releases/2006/240806.shtml>

governance. However, investors and other stakeholders must take note that disclosure alone does not guarantee that good governance will occur in practice.

FINDINGS BY PRINCIPLE

Principle 1: Ethical standards

Directors should observe and foster high ethical standards

25. Although most issuers reviewed (71%) disclose that high ethical standards are important to them, only 57% disclose that they have a written code of ethics, with even fewer (31%) publishing this document. Only five issuers (7%) disclose how corporate conduct is actively monitored to ensure compliance with the code of ethics.
26. These low percentages are surprising given that ethical practice is central to all aspects of good corporate governance. Governance structures are unlikely to be effective unless boards are committed to high ethical standards and conduct.
27. Publishing a code of ethics is considered best practice as it signals to investors the quality of an entity's corporate values and ethical standards. However, a code of ethics is only effective if directors and employees actively adhere to monitor and enforce the code in corporate decision making and governance practices.
28. The Commission recommends that an entity demonstrates a commitment to high ethical standards by:
 - (a) Ensuring it has a code of ethics relevant to the nature of its business;
 - (b) Disclosing in its annual report or on its website the existence of that code, and how that code has been implemented, monitored and enforced;
 - (c) Publishing its code of ethics on its website; and
 - (d) Disclosing relevant details of how the code has been adhered to or breached, including any consequences. Disclosure of such information can be made in a manner which adheres to employment obligations and does not breach commercial sensitivity.
29. Fisher & Paykel Appliance Holdings Limited provides a good example of Principle 1 disclosures. The entity provides clear disclosures in its 2009 annual report and its Code of Conduct is published on its website. The entity also disclosed in its annual report that no serious instances of unethical behaviour had been reported.

Principle 2: Board composition and performance

There should be a balance of independence, skills, knowledge, experience, and perspectives among directors so that the board works effectively

30. The Principle 2 reviews focused on disclosures relating to directors' independence and executive/non-executive status. Eighty-eight percent of issuers reviewed disclose information on Principle 2.
31. The Commission has established specific guidelines for publicly owned entities in relation to board composition and performance. Most of the publicly owned entities reviewed adhere to the following best practice guidelines:
 - (a) 96% have a chief executive who is separate from the chairperson;
 - (b) 81% have a majority of non executive directors;
 - (c) 79% have at least a third of directors who are independent; and
 - (d) 68% have an independent chairperson.
32. Sixteen issuers have not clearly disclosed their directors' independence and/or executive status. On eight occasions, disclosures on the chairperson's independence have been unclear. In addition, some issuers provide limited disclosures on directors' qualifications and experience. Issuers must provide clearer and more comprehensive disclosures on these matters so that investors can assess whether the range and balance of independence, qualifications, skills and diversity, such as gender,¹⁴ are appropriate for an effective board.
33. To assist investors and other stakeholders in assessing a board's competence and independence, the Commission recommends that issuers disclose:
 - (a) The criteria for independence and how each independent director meets this criteria;
 - (b) Which directors are executive or non-executive;
 - (c) Which non-executive directors are independent directors, including disclosure of why any non-executive directors are not considered independent directors;
 - (d) Information regarding directors' qualifications and value that they contribute to the board; and
 - (e) Processes for and the outcomes of any board and/or board committee performance reviews.
34. In its 2009 Annual Report, Comvita Limited (Comvita) provides a good example of clear and informative disclosures on directors' independence status and qualifications. Entities may wish to follow Comvita's example or consider other ways in which independence status and qualifications can be clearly disclosed e.g. via tables or charts.

¹⁴ Financial Reporting Council Limited, 2010, June. *The UK Corporate Governance Code*. Available URL: <http://www.frc.org.uk/corporate/ukcgcode.cfm>.

Principle 3: Board committees

The board should use committees where this would enhance its effectiveness in key areas while retaining board responsibility.

35. The majority of publicly owned entities reviewed provide information on their use of board committees. For example, 87% of the publicly owned entities reviewed disclose that they have an audit committee and 64% have a remuneration committee.
36. The reviews focused on disclosures relating to audit committees because they are increasingly accepted as best practice in corporate governance internationally and in New Zealand.
37. Of the publicly owned entities with audit committees, 91% comprise all non-executive directors, most of whom are independent. The Commission recommends that executive directors do not sit on audit committees due to conflicts of interest, particularly relating to financial reporting, internal controls and audit processes.
38. Most issuers clearly disclose that their audit committee chairpersons are not the chairpersons of the board, with the exception of ten issuers. One issuer's board chairman is identified as the audit committee chair and nine issuers did not clearly disclose who was the audit committee chair. For accountability purposes, the Commission recommends all entities designate an audit committee chair who is not the board chair.
39. Although most of the publicly owned entities reviewed disclose that their audit committees have a charter, only 43% make them publicly available. Publishing board committee charters may enable investors and stakeholders to better assess a board committee's effectiveness. The Commission recommends that all entities ensure their board committee charters are publicly available, e.g. via the company website.
40. Approximately 65% of publicly owned entities with an audit committee clearly disclose that they have an audit committee member who is a chartered accountant or a member who has other financial expertise. The Commission recommends that all entities clarify in their disclosures whether their audit committee has appropriate financial expertise.
41. A lack of accounting expertise on an audit committee may affect the committee's ability to independently assess compliance with New Zealand International Financial Reporting Standards (NZ IFRS) and New Zealand Generally Accepted Accounting Practice (GAAP).

42. The global financial crisis (GFC) highlighted the importance of having robust risk management policies, systems and practices as part of effective corporate governance.¹⁵ In particular, the GFC highlighted the issue of the potential incompatibility between risk management and audit committee functions.¹⁶
43. The issue is that the oversight and management of risk is a forward-looking function as it relates to the identification and oversight of business risks in real-time. This contrasts with the audit committee's backward-looking risk function that primarily focuses on the implementation of policies already decided by the board. In addition, there is potential for audit committees to be over-burdened by increasing demands from statutory, accounting and other requirements relating to the preparation of financial reports. Consequently, due regard may not be made to forward-looking risk matters.
44. We note that most issuers reviewed had a single "audit and risk" committee that addressed both these functions. The Commission recommends that issuers consider establishing a separate risk committee that is responsible for the oversight and management of business risks and future risk strategy. The risk committee's function and responsibilities should comprise oversight and counsel to the board on addressing the entity's current and future business risks and developing an effective future risk strategy for the entity.¹⁷
45. A few issuers established corporate governance committees to ensure that they maintain high standards of corporate governance and remain informed of international developments in corporate governance best practice. For example, the Warehouse Group Limited's Corporate Governance Committee. The charter for this committee is available on its website.
46. The Warehouse Group Limited's board committee disclosures in its 2008 annual report and on its website are a good example of Principle 3 disclosures.

Principle 4: Reporting and disclosure

The board should demand integrity both in financial reporting and in the timeliness and balance of disclosures on entity affairs.

47. Most issuers disclose some information in respect of Principle 4. This includes disclosure of board and committee charters as well as risk management policies. As discussed in Principle 3, most issuers have audit committees as a means of enhancing the integrity of financial reporting.

¹⁵ Walker, David, 2009, November 26. *A review of corporate governance in UK banks and other financial industry entities – Final recommendations*. Available URL: http://www.hm-treasury.gov.uk/walker_review_information.htm.

¹⁶ *ibid.* Recommendation 23.

¹⁷ See also Financial Reporting Council Limited, 2010, June. *The UK Corporate Governance Code*. Available URL: <http://www.frc.org.uk/corporate/ukcgcode.cfm> at C.2 Risk Management and Internal Control.

48. Listed issuers disclose little information on whether they have compliance procedures to meet continuous disclosure requirements. Of the NZX listed issuers reviewed, 44% state that they adopt formal continuous disclosure policies and procedures. Some issuers publish their continuous disclosure procedures as part of broader communications and disclosure policies, e.g. Fisher & Paykel Appliance Holdings Limited and Auckland International Airport Limited.
49. Disclosing an issuer's continuous disclosure procedures may provide greater confidence for investors and other stakeholders that they will receive material information on a timely basis. The existence of continuous disclosure compliance systems and their effectiveness has been considered by Australian courts in assessing penalties for non-compliance.¹⁸ The Commission takes compliance with continuous disclosure law seriously and has recently commenced proceedings against an issuer alleging non compliance with this law.¹⁹
50. The Commission recommends all listed issuers publish any continuous disclosure policies, procedures and practices in their annual reports or on their websites. These policies should clearly outline those responsible for ensuring compliance by the company with continuous disclosure regulations.

Principle 5: Remuneration

The remuneration of directors and executives should be transparent, fair, and reasonable.

51. Most issuers disclose some information relating to directors' and executives' remuneration. We consider that the following findings are a significant improvement on our 2005 reviews:
- (a) 65% of all issuers disclose relevant details relating to their remuneration policy for directors and executives (2005: 40%);
 - (b) 34% of publicly owned entities have published that document in full (2005: 25%); and
 - (c) 64% percent of publicly owned entities disclose they have a remuneration committee.
52. We consider that improvements in disclosures relating to this Principle may be a result of the increased scrutiny and sensitivity of directors and executives' remuneration.

¹⁸ As can be seen in *Australian Securities and Investments Commission v Chemeq Ltd* (2006) 58 ACSR 169; 24 ACLC 806; [2006] FCA 936.

¹⁹ The Securities Commission, 2010, 13 April *Commission to sue Nuplex Industries Limited and directors* Available URL: <http://www.secom.govt.nz/new/releases/2010/1304101.shtml>

53. Fisher & Paykel Healthcare Corporation Limited's 2009 Annual Report provides clear remuneration disclosures on its remuneration committee and its remuneration policies for remuneration of directors and senior management.
54. The importance of the relationship between remuneration and risk should be reflected in corporate governance policies, practices and disclosures. In particular, remuneration incentives should align with financial and non-financial performance measures relating to the issuer's objectives, and be compatible with risk management policies and systems.²⁰
55. To further improve remuneration disclosures, the Commission recommends that issuers disclose the extent to which the issuer's remunerations policies are aligned with the risk appetite and performance objectives of the issuer.²¹

Principle 6: Risk management

The board should regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks.

56. The Principle 6 reviews focused on whether issuers disclose if they have a risk management policy and if so, whether it is published.
57. Risk management disclosures have improved since the 2005 reviews, with most issuers providing information in this area. Sixty-eight percent of issuers disclose that they have risk management policies (2005: 55%) and 34% publish their policies in full (2005: 14%).
58. Many issuers incorporate their risk management policies within their audit committee charters. The need to consider separating risk management and audit functions is discussed under Principle 3.
59. However, few issuers disclose information on any significant risks affecting their business. This is a serious deficiency that must be addressed in the corporate governance disclosures of New Zealand entities.
60. Issuers can improve their risk management disclosures by including information on:
 - (a) Its business model - an explanation of the basis on which the issuer generates value over the long term and the strategy for delivering the long term objectives of the issuer;²²
 - (b) Its risk appetite - the nature and extent of risks the board is willing to take to achieve its strategic objectives; and

²⁰ Financial Reporting Council Limited, 2010, June. *The UK Corporate Governance Code*. Available URL: <http://www.frc.org.uk/corporate/ukcgcode.cfm>.

²¹ Walker, David, 2009, November 26. *A review of corporate governance in UK banks and other financial industry entities – Final recommendations*. Available URL: http://www.hm-treasury.gov.uk/walker_review_information.htm, Recommendation 30

²² Financial Reporting Council Limited, 2010, May. Revisions to the UK Corporate Governance Code (Formerly the Combined Code). Available URL: <http://www.frc.org.uk/corporate/ukcgcode.cfm>.

- (c) The nature and magnitude of material risks and how the board manages those risks.

This information can be presented in a risk matrix, an example of which is included in Kingfish Limited's risk management policy.

Principle 7: Auditors

The board should ensure the quality and independence of the external audit process.

61. Most issuers reviewed disclose that they have processes for ensuring the quality and independence of external auditors. This is consistent with most issuers having an audit committee²³ and by the low fees for other services provided to auditors. The average fee composition paid to auditors comprises:
 - (a) 77% for audit services;
 - (b) 10% for audit and/or assurance related services; and
 - (c) 13% for other fees.
62. Forty-four percent of issuers reviewed only paid fees to auditors for audit services and audit/assurance related services. This indicates that most issuers reviewed still use their auditors for consulting or other services. All such services should be subject to the approval of the board or audit committee.
63. In several instances, the audit fees paid have not been disclosed because the fee was borne by another party e.g. an entity's parent or manager. Where this is the case, we recommend issuers disclose additional information on how auditor independence is maintained. For example, subsidiaries could disclose whether the parent's audit committee directly monitors all fees paid to the subsidiary's auditors.

Principle 8: Shareholder relations

The board should foster constructive relationships with shareholders that encourage them to engage with the entity.

64. Disclosures on shareholder relations are low. Thirty-eight percent of publicly owned entities state that they have shareholder relations policies and only 30% publish these policies.
65. Good governance requires structures and behaviour that promote good shareholder relations. Publicly owned entities should publish clear shareholder relations policies that emphasise effective shareholder communications and shareholder participation. Issuers will be better placed to attract the capital and support they need if shareholder-entity relationships are cooperative and mutually responsive.
66. The Commission recommends entities establish and publish their shareholder relations policies. Entities should disclose any steps adopted to ensure that shareholders can actively participate in annual and special meetings.

²³ Refer to Principle 3: Board Committees.

67. Good disclosers on this Principle include Fonterra Co-operative Group Limited (Fonterra) and Fisher & Paykel Healthcare Corporation Limited (FPH). Fonterra established a Shareholder Relations Committee and discloses its shareholder relations policy (as part of its board charter) on its website. FPH publishes its Shareholder Communication Policy Summary on its website.
68. Institutional investors have an important role to play in the corporate governance framework. An institutional investor should make an informed decision on whether to actively engage with the issuer on governance matters. In the UK, the Institutional Shareholders' Committee's Code on the Responsibilities of Institutional Investors is designed to improve the quality of dialogue between institutional investors and the entity to improve long-term returns to investors, decrease the risk of adverse outcomes as a result of poor strategic decisions and to foster effective governance. In particular, Principle 4 of the Code notes that institutional investors should consider intervention when they have concerns about the issuer's strategy and performance, its governance or its approach to the risks arising from social and environmental matters.²⁴
69. The Commission recommends that New Zealand institutional investors continue to actively engage with issuers in order to foster good corporate governance and improved long-term returns on investment. We recommend that institutional investors review the Institutional Shareholders' Committee's Code on the Responsibilities of Institutional Investors published in the UK.

Principle 9: Stakeholder interests

The board should respect the interests of stakeholders within the context of the entity's ownership type and its fundamental purpose.

70. Disclosures on stakeholder interests remain the lowest across all Principles at 38%. Few issuers (26%) disclose that they have stakeholder interests' policies and these are generally not published.
71. The Commission recommends that issuers establish and publish clear stakeholder policies. These policies should be tailored appropriately to the issuer's nature, purpose and operations. Policies should outline issuers' relationships with significant stakeholders and evaluate whether issuers' conduct adheres to widely-accepted ethical, social and environmental norms. In particular, debt issuers should have clear policies for their relationships with debt security holders.

²⁴ Institutional Shareholders Committee, 2009. *Code on the Responsibilities of Institutional Investors*.

Available URL:

<http://institutionalshareholderscommittee.org.uk/sitebuildercontent/sitebuilderfiles/ISCCode161109.pdf>.

The Walker Report recommends that both UK and overseas institutional investors adopt the Code: see Recommendation 17. This code has been used as the basis for the UK Stewardship Code published by the UK Financial Reporting Council (FRC) in July 2010. The FRC encourages all institutional investors to report if and how they have applied the Code. The UK Stewardship Code is available online at <http://www.frc.org.uk/corporate/investorgovernance.cfm> (accessed, 8 July 2010).

72. Good disclosers include:
- (a) The Warehouse Group Limited, which discloses stakeholder interests in a separate social and environmental report;
 - (b) Trustpower Limited, which has a Sustainability Outlook section which details how it engages with and responds to key stakeholders' interests and concerns (including the environment); and
 - (c) New Zealand Post Limited, which discloses how it engages with stakeholders and how it meets each stakeholder group's interests in its annual report.
73. To meet Principle 9, the Commission recommends entities to report on Environmental, Social and Governance (ESG) matters relevant to each entity's purpose, nature and operations. Investors are increasingly considering ESG performance when valuing companies.²⁵ Entities should therefore provide transparent and meaningful ESG disclosures in annual reports, on websites and through continuous disclosure requirements.
74. The Global Reporting Initiative (GRI) is widely considered a leading standardised framework for ESG reporting (www.globalreporting.org). In its 2009 review, the Sustainable Investment Research Analyst Network (SIRAN) found that 55 of the companies in the United States S&P100 made specific reference to GRI in their sustainability reports.²⁶ In 2009, 10 New Zealand companies reported under the GRI. We recommend entities adopt GRI frameworks as a means of achieving Principle 9.

²⁵ For example, the New Zealand Super Fund considers ESG matters as part of its investment strategy. (<http://www.nzsuperfund.co.nz>)

²⁶ See http://www.siran.org/projects_s_and_p_reporting_comparison.php. New Zealand is following the ESG trend.

CONCLUSION

75. Transparent disclosures are central to good corporate governance. The Commission has found that many of the issuers reviewed provide clear and relevant disclosures in relation to their board composition, use of board committees, remuneration of executives and directors, risk management and use of external auditors.
76. However, there is scope for New Zealand entities to improve their corporate governance policies, practices and disclosures. In particular, we recommend entities reconsider their disclosures on ethical standards, risk management, remuneration, shareholder relations and stakeholder interests. For example, entities should consider whether it is appropriate to separate their risk management and audit committee functions.
77. The Commission, along with other regulators internationally, is reconsidering corporate governance best practice. Therefore it is important for New Zealand entities to remain up-to-date on developments in corporate governance and appropriately implement these in their organisations.
78. The Commission appreciates the cooperation and positive responses received from issuers in relation to these reviews. We wish to thank these issuers for their efforts in promoting good corporate governance in New Zealand.
79. The Commission will continue to review issuers' corporate governance disclosures as part of its Corporate Governance Review Programme.
80. We welcome any comments or enquiries from the public relating to this report.

APPENDIX 1: THE SECURITIES COMMISSION PRINCIPLES FOR CORPORATE GOVERNANCE

1. **Ethical standards:** Directors should observe and foster high ethical standards.
2. **Board composition and performance:** There should be a balance of independence, skills, knowledge, experience, and perspectives among directors so that the board works effectively.
3. **Board committees:** The board should use committees where this would enhance its effectiveness in key areas while retaining board responsibility.
4. **Reporting and disclosure:** The board should demand integrity both in financial reporting and in the timeliness and balance of disclosures on entity affairs.
5. **Remuneration:** The remuneration of directors and executives should be transparent, fair, and reasonable.
6. **Risk management:** The board should regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks.
7. **Auditors:** The board should ensure the quality and independence of the external audit process.
8. **Shareholder relations:** The board should foster constructive relationships with shareholders that encourage them to engage with the entity.
9. **Stakeholder interests:** The board should respect the interests of stakeholders within the context of the entity's ownership type and its fundamental purpose.

APPENDIX 2: LIST OF ISSUERS REVIEWED

AMP Investments' World Index Fund	Opus International Consultants Limited
AMP NZ Office Trust	Origin Energy Contact Finance No.2 Limited
Aquiline Holdings Limited	Postie Plus Group Limited
ASB Capital Limited	Powerco Limited
Auckland International Airport Limited	Property Finance Group Limited
Australian 20 Leaders Funds	Property for Industry Limited
Barramundi Limited	Pumpkin Patch Limited
Beneficial Finance Limited	Quayside Holdings Limited
BLIS Technologies Limited	Ravensdown Fertilizer Co-operative Limited
Boston Finance Limited	Renaissance Corporation Limited
Cavalier Corporation Limited	Satara Co-operative Group Limited
Celsius New Zealand Income Fund Series 1	Savoy Equities Limited
Comvita Limited	Sky Network Television Limited
Delegats Group Limited	Smartpay Limited
Diligent Board Member Services Inc	South Canterbury Finance Limited
Dorchester Finance Limited	Southern Travel Holdings Limited
Fidelity Capital Guaranteed Bond Limited	Southland Building Society
Fisher & Paykel Appliance Holdings Limited	Southport New Zealand Limited
Fisher & Paykel Healthcare Corporation Limited	St Laurence Limited
Fonterra Co-operative Group Limited	Strategic Finance Limited
Genesis Research and Development Corporation Limited	Syft Technologies Limited
Geneva Finance Limited	The New Zealand Refining Company Limited
Hallenstein Glasson Holdings Limited	The Warehouse Group Limited
Horizon Energy Distribution Limited	TRS Investments Limited
IMP Diversified Income Fund Limited	Trustpower Limited
Infratil Limited	Turners Auctions Limited
Kingfish Limited	UDC Finance Limited
MARAC Finance Limited	Westpac New Zealand Limited
Marlin Global Limited	Widespread Energy Limited
Methven Limited	Works Finance (NZ) Limited
Mighty River Power Limited	
New Image Group Limited	
New Zealand Farming Systems Uruguay Limited	
New Zealand Post Limited	
Northland Port Corporation (NZ) Limited	
Nufarm Finance (NZ) Limited	
Nuplex Industries Limited	
NZF Group Limited	

