

“Corporate governance in New Zealand has undergone some significant changes.”

Changes to New Zealand’s corporate governance regime

Corporate governance in New Zealand has undergone some significant changes in recent times. These include the recent corporate governance-related changes to the NZX Listing Rules and the corporate governance principles and guidelines released by the Securities Commission. This newsletter summarises the key changes in these areas.

Corporate governance amendments to the NZX Listing Rules

After consultation with listed issuers and other interested parties, NZX adopted a Corporate Governance Best Practice Code (**Code**) and several governance-related amendments to the NZX Listing Rules. The amendments to the NZX Listing Rules focus, primarily, on ensuring the independence of the board and audit committee of listed issuers. Compliance with the amended rules is mandatory.

The Code sets out best practice for various corporate governance matters including the composition and operation of board committees, director remuneration and codes of ethics.

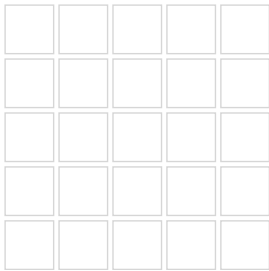
Although compliance with the Code is not mandatory, a listed issuer is required to disclose in its annual report whether the corporate governance principles adopted by it differ materially from those set out in the Code.

The amendments to the NZX Listing Rules and the adoption of the Code are effective from the later of 29 October 2004 or the date which is 12 months after the date of the listed issuer’s 2003 annual meeting.

Principles and guidelines of the Securities Commission

In June 2003, the Minister of Commerce asked the Securities Commission to develop corporate governance principles for New Zealand. In February 2004, after an extensive public consultation process, the Securities Commission released the following principles:

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.
3. **Board committees.** The board should use committees where this would enhance the board’s effectiveness in key areas, while retaining board responsibility.
4. **Reporting and disclosure.** Demand integrity both in financial reporting and in the timeliness and balance of disclosures relating to the entity’s affairs.
5. **Remuneration.** Remuneration of directors and executives should be transparent, fair and reasonable.
6. **Risk management.** Regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks.
7. **Auditors.** Ensure the quality and independence of the external audit process.
8. **Shareholder relations.** Foster



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constructive relationships with shareholders that encourage them to engage with the entity.

9. **Stakeholder interests.** Respect the interests of stakeholders within the context of the entity's ownership type and its fundamental purpose.

As with the Code, compliance with the principles developed by the Securities Commission is not mandatory. Entities are expected to disclose in their annual report (or, for entities that do not distribute annual reports, some other appropriate alternative) whether and how they have complied with the principles.

Entities to which the principles apply

The Securities Commission intends that the identified corporate governance principles will apply to all entities that have economic impact in New Zealand or are accountable to the public.

This includes "listed issuers, other issuers, state-owned enterprises, community trusts and public sector entities". The reference to "other issuers" would seem to include widely-held private companies, Crown-owned entities and local authorities. The principles will therefore apply to most, if not all, substantial businesses in New Zealand.

The Securities Commission's discussion document acknowledges that not all nine corporate governance principles will apply in their entirety to all types of entities.

In particular, the Securities Commission noted that public sector organisations should observe the principles to the fullest extent they reasonably can and only depart from them where they are

subject to competing statutory or public policy requirements.

Compliance with the principles

The principles are intended to be high-level objectives which entities should aim to achieve. In respect of each principle, the Securities Commission has identified certain guidelines which set out structures and processes that can be adopted by entities in order to comply with the principles.

The guidelines are suggested ways of achieving each principle. It will not be necessary for an entity to comply with, and report against, each of the guidelines if the relevant corporate governance principle can be achieved in other ways. This approach recognises that different types of entities and businesses can take different approaches to achieving good corporate governance.

Each entity therefore has the flexibility to explain in its annual report the procedures adopted by it to meet the principles and justify why departures from the specified corporate governance standards are appropriate to that entity and its operations.

Status of the principles

One concern raised by several interested parties through the consultation process was what would be done with the principles once they were developed. Several dual listed companies are currently complying with either the corporate governance principles set out in the ASX Principles of Good Corporate Governance or the US Sarbanes-Oxley Act of 2002 as well as the new corporate

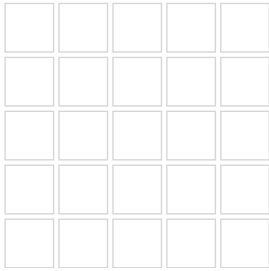
governance regime adopted by NZX. There was a concern that any further rules would increase compliance costs with no real improvement in corporate governance practices.

The Securities Commission has sought to address this concern. The Commission states that the principles do not impose any new legal obligations on issuers – the NZX Listing Rules already require a listed issuer to include a statement of its corporate governance policies in its annual report.

Listed issuers that have high standards of corporate governance are likely to already address all the areas covered by the principles. Where a listed issuer's existing disclosure does not address all the areas covered by the principles, that issuer should then consider adopting and reporting on the relevant principles.

The Securities Commission also recognises that formal corporate governance reporting will be new for smaller unlisted entities. Although it may take some time for such entities to achieve and report against all the principles, the Commission's view is that such entities should report to their investors and stakeholders on progress made towards observing each principle.

The Securities Commission has stated that it will continue to "focus strongly" on corporate governance in its enforcement work and will comment or take other action where it finds examples of poor governance. The Commission does not state how it proposes to enforce the principles and it is not clear whether the relevant companies and securities legislation is to be amended to give the Commission specific powers of enforcement.



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Regulation of auditors

In the United States, the Sarbanes-Oxley Act of 2002 provides for the establishment of the Public Company Accounting Oversight Board. The PCAOB is an independent body whose function is to oversee the manner in which both US and non-US accounting firms audit issuers whose securities are listed in the US.

The Securities Commission's report states that it considers the independent oversight of auditors would contribute to confidence in audit quality and auditor independence, and that it will recommend to the Government that a similar oversight body should be established in New Zealand.

Governance initiatives relating to Crown entities

The Public Finance (State Sector Management) Bill was recently

introduced into Parliament. The Bill, when passed into law later this year, will create a new Crown Entities Act, which aims to:

- improve governance and accountability of Crown entities; and
- create more uniformity between Crown entities that operate in a similar way.

The Bill contains detailed provisions for the appointment and removal of board members of Crown entities.

The Bill imposes various collective and individual duties on board members, although not all of these duties will apply to Crown entity companies. Collective duties include the duty to act consistently with the entity's objectives, functions, statement of intent and output agreement, the duty to perform functions efficiently and effectively, and the duty to operate in a financially responsible manner.

Individual duties include the duty to act in good faith, exercise the care, diligence and skill of a reasonable person, not to disclose or make use of certain information and to act with honesty and integrity. The Bill also makes Crown entity board members subject to reasonably strict conflict of interest requirements.

Advice and information

For further advice and information on corporate governance, please contact your usual Bell Gully adviser or one of the people listed below.

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