

FINANCIAL MARKETS AUTHORITY

CORPORATE GOVERNANCE IN NEW ZEALAND

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Principles and Guidelines

A handbook for directors, executives and advisers



FINANCIAL MARKETS AUTHORITY

TE MANA TATAI HOKOHOKO - NEW ZEALAND

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Corporate Governance in New Zealand: Principles and Guidelines
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PRINCIPLES FOR CORPORATE GOVERNANCE

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To ensure an effective board, there should be a balance of independence, skills, knowledge, experience and perspectives.

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INTRODUCTION

This handbook is intended as a reference for directors, executives and advisers to decide how best to apply the principles to their particular entity.

Our role at the FMA is to regulate capital markets and financial services in New Zealand, to support improved outcomes for investors, professionals and businesses. We recognise the vital role good corporate governance plays in contributing to markets that are fair, efficient and transparent, and to ensuring stakeholders' interests are respected. Appropriate processes and systems help to manage risks and allow those in governance roles to focus on growth, value creation and the long-term sustainability of their businesses.

The Securities Commission published a handbook, *Corporate Governance in New Zealand: Principles and Guidelines*, in March 2004. The handbook was a shortened version of a fuller report, *Corporate Governance in New Zealand: Principles and Guidelines*, published in February 2004. The report and handbook set out nine principles for application within a broad range of entities.

In recent years, there has been an increasing focus on corporate governance, particularly in light of the contribution of governance failings to the impact of the Global Financial Crisis (GFC). Many jurisdictions have updated their corporate governance codes as a result. In New Zealand we saw the collapse of many finance companies with substantial investor losses. As a result, directors have been held accountable for the decisions they made and the levels of company oversight they had as directors of those companies at that time. Against this context, we have taken the opportunity to refresh the principles for corporate governance so they remain a current and useful guide. We have considered the current issues directors face in their governance roles, and relevant aspects of international best practice.

The OECD Corporate Governance Committee began a review of their principles in late 2014. When that review is complete we will make any necessary updates to these principles.

Principles

The approach taken in this handbook recommends that boards provide sufficient meaningful information

to show how they meet nine high-level principles. We focus on principles, rather than taking a prescriptive approach, because a 'one size fits all' effort is inappropriate for the broad range of entities this handbook applies to. Given the high-level nature of the principles, we ask boards to explain how they comply with each principle, rather than 'comply or explain why not'. This allows for flexibility in reporting, which is particularly important for entities that may also need to comply with other corporate governance principles - such as the principles published by New Zealand Exchange (NZX) or Australian Securities Exchange (ASX).

The principles outlined in this handbook contribute to high standards of corporate governance in New Zealand. High standards are achieved when directors and boards implement the principles through their structures, processes and actions, and demonstrate this in their public reporting and disclosure. The principles are not necessarily shown in order of priority. Principles 1 to 7 all deal with how boards should govern. This good governance will benefit shareholders and other stakeholders. Principles 8 and 9 then deal with the board's relationship with shareholders and other stakeholders.

Guidelines

This handbook sets out guidelines, which are examples of the types of corporate governance structures and processes that will help entities comply with each principle. Whether these guidelines are suitable for a particular entity or not will depend on a number of factors. The principles are expressed broadly and different entities will find different ways of achieving them in a manner that is appropriate for each entity's size, activities and ownership structure. We do not expect entities to report against the specific guidelines.

Commentary

This handbook also provides commentary from the FMA on each of the nine principles. You can download a copy of this handbook from the FMA's website www.fma.govt.nz

CHANGES IN THIS REVISED VERSION

The principles for corporate governance outlined in the 2004 original handbook are still highly relevant for boards, and in most cases continue to be appropriately framed. With this in mind, we have refreshed the content in the following areas.

How to report against the principles

We recognise that the audience for annual reports is broad, and the way people access and receive their information is changing rapidly. We have therefore referred to reporting against the principles both in annual reports and on company websites, or a combination of both. Where this handbook refers to 'reporting' against the principles, this includes publishing information on company websites.

Ethical standards

We have included some additional points on ethical standards for boards to consider, in line with the recently revised ASX principles for corporate governance.

Composition and diversity

We have included additional factors for boards to consider, in particular the reporting of performance against diversity policies to shareholders and stakeholders. We have clarified that diversity includes considerations of gender, ethnicity, cultural background, age and specific relevant skills.

Board committees

We have highlighted the important role of audit committees and included commentary on other committees – such as risk committees – that boards, depending on their size and particular needs, may wish

to consider to complement their governance structures. We have encouraged the publishing of all committee charters on company websites.

Reporting

This section has been updated to reflect changes in audit and accounting standards and terminology. We have also updated the continuous disclosure commentary for listed issuers.

Remuneration

While we have made only minor changes to this section, the changes are intended to increase boards' focus on ensuring transparent remuneration arrangements, such as providing greater transparency on incentive payments.

Risk management

With an increased global focus on risk management, we have updated this section to ensure boards have appropriate risk frameworks and strategies in place, have appropriate oversight of these, and report to their investors on these matters.

Auditors

Our updates in this section reflect changes to practices and legislation since 2004, while retaining the focus on audit quality and independence.

WHO THE PRINCIPLES APPLY TO

The principles outlined in this handbook can be generally applied to the governance of entities that have economic impact in New Zealand, or those entities that are accountable, in various ways, to the public.

This includes listed issuers, other issuers of securities, state-owned enterprises, community trusts, public sector entities, and may also include other companies.

We encourage boards to take the lead in embedding sound corporate governance practices that are appropriate for the size and scale of their organisation. This includes practices that have a positive impact on relationships with customers, shareholders and stakeholders.

Not all of the principles will apply entirely to all entities. We encourage entities to consider the nature and needs of their businesses when considering how the principles apply to them. Public sector organisations, for instance, do not have shareholders in the traditional sense, and are subject to specific board appointment processes. However, they have an owner and are accountable to that owner, as well as to other stakeholders and the public. These entities should observe the principles to the fullest extent they reasonably can, except where they are subject to competing statutory or public policy requirements.

The FMA's primary focus is on issuers of securities and entities providing financial services. The principles do not impose any new legal obligations on these entities. However, they set out standards of corporate governance that the FMA expects boards to observe and to report on to their investors and other stakeholders.

Publicly owned entities have particular corporate governance responsibilities to their shareholders. Other entities, such as managed investment schemes, have investors with similar ownership interests to company shareholders, and similar voting rights. Where this handbook uses the terms 'publicly owned entity' and 'shareholders', these entities should consider how the relevant provisions might apply to their own structure.

The principles in this handbook are different to the governance obligations that apply to issuers of debt securities, managers of managed investment schemes and their supervisors under Part 4 of the *Financial Markets Conduct Act 2013* (FMC Act). However, these principles will still be useful for these groups as they consider their governance frameworks against the new obligations under the FMC Act. The principles recognise that different types of entities can take different approaches to achieving good corporate governance. Good governance practices should reflect the nature of each entity, its ownership structure, and the range and interests of stakeholders.

The FMA will continue to focus strongly on corporate governance in its market engagement and conduct work. We will comment on, or take appropriate and proportionate action, where we find examples of poor governance.

HOW TO REPORT AGAINST THE PRINCIPLES

All entities

The FMA's recommended approach for corporate governance depends heavily on disclosure of corporate governance practices. Implementing the principles must therefore include reporting on corporate governance practices to shareholders and other stakeholders. For most entities this can be achieved in the annual report, or through links to online content. Company websites should have strong corporate governance sections, easily accessible to stakeholders.

The principles are formulated so that entities can report on how they have performed against each principle. Boards should focus on providing sufficient, useful information to show stakeholders how the entity performs against the relevant principle. Where detailed reporting is already provided against other corporate governance principles (such as the principles published by NZX or ASX), there may be no need to provide additional information against a particular principle in this handbook. Reporting is likely to include a brief description of the structures and processes put

in place by the board to help it fulfil its governance responsibilities, and how it has used them.

Directors should consider their own, and the company's, performance against each of the principles before information is prepared. The principles should be 'owned' by the board, and not approached through a simple 'tick box' compliance system delegated entirely to management.

We expect boards to find an opportunity each year to discuss and measure their performance against the principles, including making any suggested improvements.

The guidelines in this handbook are intended to help entities think about how they can achieve each principle. We do not expect entities to report specifically against the detail in the guidelines. Reporting should instead show how an entity has achieved the principles.

Listed issuers

Listed issuers who have high standards of corporate governance are likely to be already addressing all the issues covered by the principles, both by adopting certain practices and by reporting on them. They report on these under NZX Listing Rule 10.4.5(h), which requires annual reports to include *“a statement of any corporate governance policies, practices and processes, adopted or followed by the Issuer”*. For the many listed issuers who already have a high standard of governance practices and reporting, adopting the principles is unlikely to impose any new requirements or additional reporting.

However, listed issuers whose reporting under NZX Listing Rule 10.4.5(h) does not cover all the corporate governance areas outlined in these principles should examine their practices with a view to adopting and reporting on all of the principles.

The principles do not, therefore, impose a dual reporting regime; rather these principles should complement listed issuers' obligations under the NZX Listing Rules and other applicable rules.

Listed issuers have continuous disclosure obligations under the NZX Listing Rules. Proper observance of corporate governance is an important contributor to transparency and efficiency in the capital markets. Some matters relevant to corporate governance could be 'material information' that must be disclosed. Nothing in this document, particularly in relation to the content of annual reports, should detract from any obligation a listed issuer has to disclose a matter under the continuous disclosure NZX Listing Rules.

Formal corporate governance reporting may be new to some smaller unlisted entities. We believe that all entities should think about their corporate governance practices; however, we are also aware that it may take time for some smaller entities to achieve and report against all the principles. In the meantime, we think it would be helpful for smaller entities to report to their investors and stakeholders on progress made towards observing and reporting on each principle.

The background of the page is a grayscale photograph of a desk. On the desk are several items: a stack of papers, a pen, and two books. One book is titled '2014 APPLICABLE FINANCIAL REPORTING' and mentions 'New Zealand Equivalents to International Financial Reporting for Tier 1 and Tier 2 For-Profit Entities'. Another book partially visible on top of it says 'NEW ZEALAND GOV'.

Principle 1: Ethical standards

Directors should set high standards of ethical behaviour, model this behaviour, and hold management accountable for delivering these standards throughout the organisation.

PRINCIPLES AND GUIDELINES

Guidelines

- The board of every entity should adopt a written code of ethics that is a meaningful statement of its core values. The code should set out explicit expectations for ethical decision making and personal behaviour in respect of:
 - acting honestly and with high standards of personal and professional integrity
 - conflicts of interest, including any circumstances where a director may participate in board discussion, and voting on matters in which he or she has a personal interest
 - proper use of an entity's property and/or information, including not taking advantage of the entity's property or information for personal gain, except as permitted by law
 - not participating in any illegal or unethical activity, including safeguards against insider trading in the entity's securities
 - fair dealing with customers, shareholders, clients, employees, suppliers, competitors and other stakeholders
 - giving and receiving gifts, koha, facilitation payments and bribes
 - compliance with laws and regulations that apply to the entity and its operations
 - reporting of unethical decision-making and/or behaviour
 - conduct expected of management and the board in responding to and supporting instances of whistleblowing.
- Every code of ethics should include processes for recording and evaluating compliance with the code and measures for dealing with breaches of the code.
- Every entity should communicate its code of ethics to its employees and provide employee training and procedures to clearly set out these expectations. For example, the board should establish its expectations on management's response to instances of whistleblowing and ensure that whistleblowing procedures and appropriate training are provided. It should also clearly document its expectations and procedures for giving and receiving gifts and donations. Boards should be clear on their policy regarding giving and receiving koha where cultural practices and approaches can vary and the perception of undue influence is high.
- Every board should have a system to implement and review the entity's code of ethics. The board should monitor adherence to the code and hold directors, executives, and other personnel accountable for acting ethically at all times.
- Every entity should publish its code of ethics. Reporting should include information about the steps taken to implement the code and monitor compliance, including any serious instances of unethical behaviour and the action taken.

FMA commentary

Ethical behaviour is central to all aspects of good corporate governance. Good governance structures encourage high standards of ethical and responsible behaviour, but can only be effective when directors and boards are also committed to these same standards. A formal code of ethics will help with this, as long as it is understood by directors and management and used to make decisions.

The benefits of a code of ethics

Under the NZX Listing Rules, listed issuers are required to have a code of ethics. More widespread adoption and implementation of codes of ethics beyond listed issuers will help bring New Zealand companies into line with international best practice and will promote public confidence in governance structures and behaviour.

Different businesses face specific ethical issues. A code of ethics needs to suit the particular circumstances and needs of the entity.


However, some common ethical issues arise in every entity that is accountable to shareholders, investors and other stakeholders. It is our view that, at a minimum, a code of ethics should address the matters set out in the guidelines above. Depending on the entity, there may be other matters that should be included. As circumstances change, codes of ethics should be reviewed, expanded or updated to ensure they remain relevant.

A code of ethics will not create ethical and responsible practices. It is simply a guide and reminder of expected behaviour, and sets standards against which behaviour can be judged. A code is ineffective unless directors and employees put it into practice. Boards need systems and processes to implement the code, and need to monitor its effectiveness. This could form part of the board's annual performance assessment.

Ultimately the board is responsible for ethical behaviour within the entity. Boards could consider convening an ethics committee to assess the performance of directors against the code of ethics. We also encourage entities to seek independent verification, on a periodic basis, of the code's implementation and effectiveness.

A code of ethics will not be effective unless there are consequences for directors and employees who breach it. An effective code of ethics will set out processes for holding individuals accountable for unethical behaviour and include appropriate sanctions. Accountability for behaviour at variance to the code will depend on who has committed the breach, such as executives or other personnel.

Transparency encourages ethical behaviour by increasing accountability. This will be enhanced if codes of ethics are published alongside meaningful information that reports on the steps taken to implement the code and monitor compliance. This reporting should include, in general terms, information about any serious instances of unethical behaviour within the entity, and the steps taken to deal with this.



Principle 2: Board composition and performance

To ensure an effective board, there should be a balance of independence, skills, knowledge, experience and perspectives.

Guidelines

- Every issuer's board should have an appropriate balance of executive and non-executive directors, and should include directors who meet formal criteria for 'independent directors'.
- All directors should, except as permitted by law and disclosed to shareholders, act in the best interests of the entity.
- Every board should have a formal charter that sets out the responsibilities and roles of the board and directors, including any formal delegations to management.
- The chairperson should be formally responsible for fostering a constructive governance culture and applying appropriate governance principles among directors and with management.
- The chairperson of a publicly owned entity should be independent. No director of a publicly owned entity should simultaneously hold the roles of board chairperson and chief executive (or equivalent). Only in exceptional circumstances should the chief executive go on to become the chairperson.
- Directors should be selected and appointed through rigorous, formal processes designed to give the board a range of relevant skills and experience.
- The board should be satisfied a director will commit the time needed to be fully effective in their role.
- The board should set out in writing its specific expectations of non-executive directors (including those who are independent).
- The board should allocate time and resources to encouraging directors to acquire and retain a sound understanding of their responsibilities, and this should include appropriate induction training for new appointees and on-going training for all directors.
- The board should have rigorous, formal processes for evaluating its performance, along with that of board committees and individual directors, including the chairperson. This could extend to formally reviewing the position of chairperson on a regular basis.
- Reporting should include information about each director, including a profile of experience, length of service, independence and ownership interests in the company. Information on the board's appointment, training and evaluation processes should also be included.

FMA commentary

The board guides the strategic direction of the entity, and directs and oversees management. The size of the board should be appropriate to meet the needs of the entity. Each director should have skills, knowledge and experience relevant to the affairs of the entity. Individual directors may bring particular attributes that complement those of other directors.

An effective board requires a range and balance of relevant attributes among its members. This will include consideration of gender, ethnicity, cultural background, age and specific relevant skills. Each director should be able and willing to commit the time and effort needed for the position.

The board should consider using a board skills and capability matrix to identify current and future skills, capability and diversity needs of the entity. Boards should report on composition and succession planning at least on an annual basis. We encourage boards to undertake an independent external review of performance on a periodic basis—for example if an annual review is performed then this could be an external review every third year.

Independence of mind is a basic requirement for directors. Each director should endeavour to have an independent perspective when making judgments and decisions on matters before the board. This means a director puts the interests of the entity ahead of all other interests, including any separate management interests and those of individual shareholders (except as permitted by law). Directors with an independent perspective are more likely to constructively challenge each other and executives—and thereby increase the board's effectiveness.

Non-executive directors and independence

Non-executive directors, with no other interests to hinder their judgement in the interests of the entity, can contribute a particularly independent perspective to board decisions. We encourage entities to establish and publish clear criteria for defining independent directors.

Board effectiveness is not always enhanced by directors' formal independence if it outweighs their independence of mind, and the skills, knowledge, experience and time that a director can contribute. Independent representation is an important contributor to board effectiveness, but only when considered along with the other attributes sought in a non-executive director.

Factors influencing independence

There may be practical constraints in New Zealand if too high a level of formal independence is required of boards. With New Zealand's relatively small pool of qualified and experienced directors, there is a risk that seeking independence at the cost of all else will lead to missed opportunities. However, the independence of directors is something that investors should have confidence in. We consider the underlying issues relating to director independence can be addressed by:

- directors having an independent perspective when making decisions
- a non-executive director being formally classified as independent only where he or she does not represent a substantial shareholder or other key stakeholder, and where the board is satisfied that he or she has no other direct or indirect interest or relationship that could reasonably influence their judgment and decision-making as a director
- the chairperson of a publicly owned entity being independent

- in every issuer, the board including independent director representation
- boards of publicly owned entities comprising
 - a majority of non-executive directors
 - a minimum one-third of independent directors
- boards taking care to meet all disclosure obligations concerning directors and their interests, and reporting including information about the directors, identifying which directors are independent, and describing the criteria used to assess independence.

Other factors that may impact a director's independence are:

- recent employment in an executive capacity by the entity or any of its subsidiaries
- having held a recent senior role in a provider of material professional services to the entity or any of its subsidiaries
- a recent or current material business or contractual relationship (eg, supplier or customer) with the entity or any of its subsidiaries
- having close family ties with any person who falls within the above categories
- having been a director of the entity for such a period that the director's independence may have been compromised.

It is also important to recognise the contribution of executives as their skills and perspectives provide a sound basis for challenge by non-executive directors. Executive representation at board meetings or on boards promotes a constructive exchange between directors and executives that is necessary for boards to be effective. To maintain proper balance between executive and non-executive directors, it can be useful for the latter to meet regularly to share views and information without executives present.

Tenure

We encourage boards to consider the length of service of each of their directors and the impact this has on the ability of directors to remain independent. Regular review of the length of board appointments will also improve the board's ability to strike the right balance between institutional knowledge and fresh thinking.

It will also ensure the board has the right mix of skills for the stage and needs of the company and should be integral to its succession planning.

Roles and responsibilities for the board and executives

Efficiency and accountability are improved if the respective roles of the board and executives are well understood by all. A board charter that sets out the responsibilities of the board and its directors, and includes details of any delegations given by the board to management, can be helpful. Directors are entitled to seek independent advice. This may be necessary to be fully informed about an issue before the board, and to effectively contribute to board decisions.

The chairperson is critical in director-executive relations. The chairperson's role includes promoting co-operation, mediating between perspectives, and leading informed debate and decision-making by the board. The chairperson should lead the process of evaluation and review of the board's performance. The chairperson also has a pivotal role between the CEO and the board. The balance between these roles is particularly important in entities with public shareholders, and works best if the roles of chairperson and chief executive (or equivalent) are clearly separated, and the chairperson is an independent director. In general, the chief executive should not move on to become chairperson. Only in special circumstances should the roles be combined, for example where an individual has skills, knowledge and experience not otherwise available to the entity (and where these circumstances are fully explained to investors).

Nomination committees

The optimum number of directors for any entity will depend on its size and the nature and complexity of its activities, as well as its requirement for independent directors. If a board is too large, decision-making becomes unwieldy; if too small, it may not achieve the necessary balance of skills, knowledge and experience.

It is vital to achieve the right mix, and to choose directors who can make an appropriate contribution, therefore rigorous selection, nomination and appointment processes are needed. A separate nomination committee can help to focus resources on this task, as well as on tenure and succession planning.

Being an effective board member

It is important that non-executive directors clearly understand their expected roles, especially if they do not have the advantage of prior knowledge of an entity. It will be of value for all directors if the board has a written statement of its expectations of their role, including the expected time commitment.

To be individually effective, directors need to make themselves familiar with both the activities of the entity and their responsibilities as a director. Induction training and professional education can be very helpful.

Effectiveness can also be enhanced if the board regularly assesses its own performance and that of its individual members against pre-determined measures of efficiency and effectiveness. We encourage boards to develop their own review and report processes as an integral element of good governance.

Principle 3: Board committees

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



Guidelines

- Every board committee should have a clear, formal charter that sets out its role and delegated responsibilities while safeguarding the ultimate decision-making authority of the entire board.
- Where boards have board committees, the charter and membership of each should be published on their website and be easily accessible.
- Proceedings of committees should be reported back to the board to allow other directors to question committee members.
- Each publicly owned company should establish an audit committee of the board with responsibilities to recommend the appointment of external auditors; oversee all aspects of the entity-audit firm relationship; and to promote integrity and transparency in financial reporting.
- Audit committees should comprise:
 - all non-executive directors, a majority of whom are independent;
 - at least one director who is a qualified accountant or has another recognised form of financial expertise; and
 - a chairperson who is independent and who is not the chairperson of the board.

FMA commentary

Board committees may not be appropriate or practical for all entities. However, in larger or more complex businesses, board committees can significantly enhance effectiveness through closer scrutiny of issues and more efficient decision-making. Committees maximise the use of directors' skills, knowledge and experience, and can help spread the workload among directors.

A committee should have an effective relationship with the board. Committee members should clearly understand the committee's purpose and role and the extent of any formal delegations from the board. A clear, formal committee charter agreed by the board is an efficient way to achieve this. Publishing the charter and information on the composition and work of committees will help investors and stakeholders to assess the role and effectiveness of board committees.

The accountability of the entire board should be maintained, including in relation to work undertaken by committees. The board should be well informed about decisions for which it retains ultimate responsibility. It is important, therefore, that committee proceedings are reported back to the board, and time is given for any director who is not on the committee to comment on or seek an explanation of the business of the committee.

The role of an audit committee

Financial reporting and audit processes are a key area of board responsibility. Audit committees are an important tool for all publicly owned entities, and we encourage their use by all issuers.

As with other committees, the role of the audit committee needs to be clearly established. This can be achieved by a formal charter, including responsibility for recommending the appointment of external and internal auditors; overseeing the entity-auditor relationship; and promoting the integrity and transparency of the entity's financial reporting.

The structure of the audit committee is particularly important, both in terms of independence and the skills required.

Remuneration committees

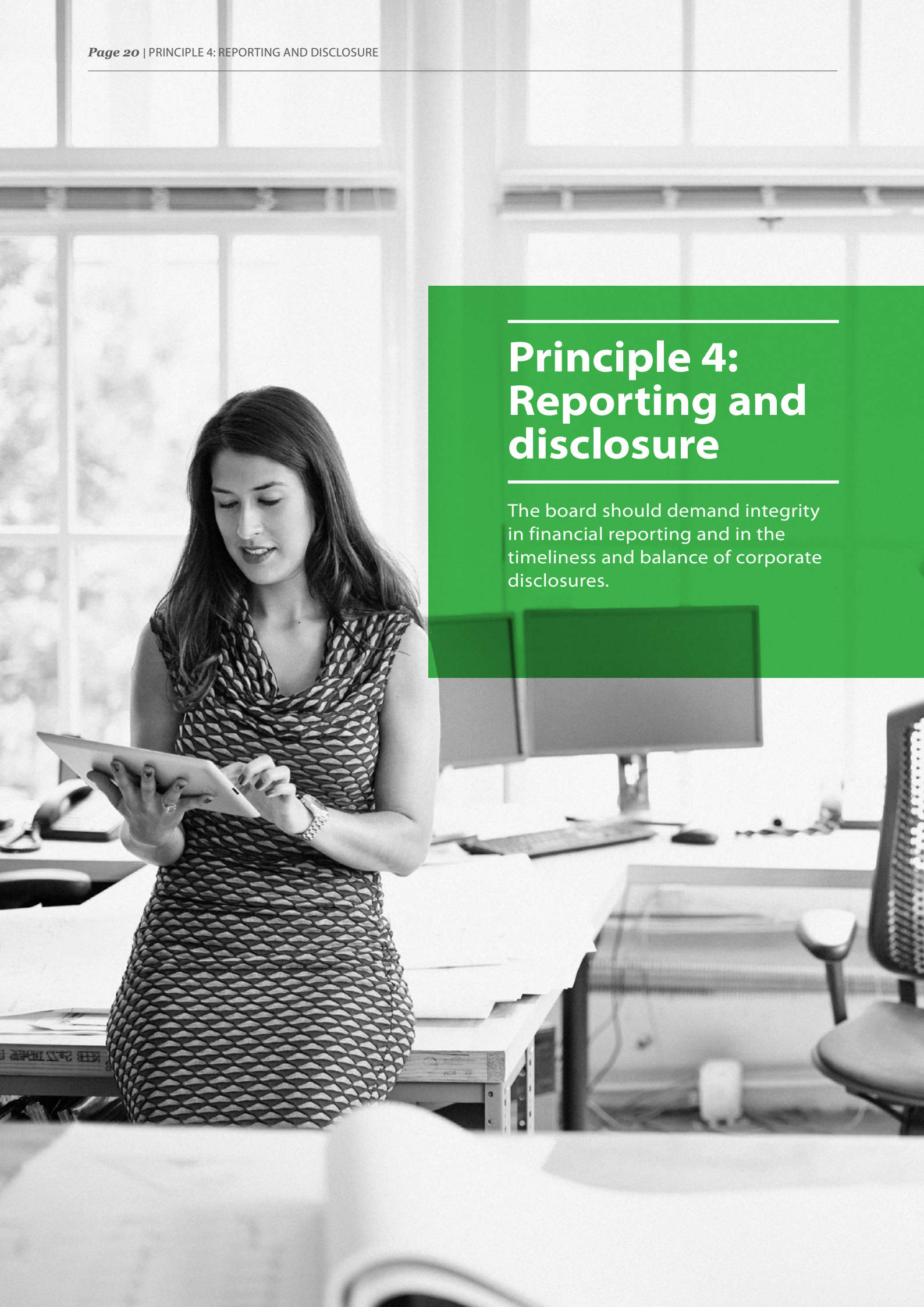
Listed entities, and entities with larger boards, can benefit from appointing a remuneration committee to make recommendations on remuneration for executive directors and other executives. Where shares or options are part of performance-related remuneration, the committee should recommend to the board (or have delegated responsibility for) an appropriate approach to valuation and disclosure. The remuneration committee should have a majority of independent directors. Listed entities should disclose and publish their policies and procedures relating to remuneration.

Other committees

Other areas of board performance could also be improved by the use of committees and particular consideration should be given to appointing a risk committee. Depending on the size and nature of the entity, a combined risk and audit committee may not be appropriate. This is because the oversight and management of risk is a forward-looking function, while the audit committee has a backward-looking function. 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, so a combined risk and audit committee may find it difficult to give due regard to forward-looking risk matters.

The commentary in Principle 2 has information on the benefit of a nomination committee. A health and safety committee may also be useful to provide oversight and accountability for safety procedures, policies and legislative compliance.

It is vital that boards give proper time and attention to these matters and that committee decisions are robust and transparent. All entities, particularly those with large boards, should carefully consider whether the use of committees could enhance their effectiveness in these key areas.

A black and white photograph of a woman with long dark hair, wearing a sleeveless dress with a geometric pattern. She is standing in an office, looking down at a tablet computer she is holding with both hands. In the background, there is a desk with a computer monitor, keyboard, and mouse, and a large window with multiple panes.

Principle 4: Reporting and disclosure

The board should demand integrity in financial reporting and in the timeliness and balance of corporate disclosures.

Guidelines

- All boards should have a rigorous process for ensuring the quality and integrity of financial statements including their relevance, faithful representation, verifiability, comparability and timeliness.
- Financial reporting and annual reports of all entities should, in addition to all information required by law, include sufficient, meaningful information to enable investors and stakeholders to be well informed. Financial statements are complex and can be challenging for readers. We encourage boards to aim for financial reports that are clear, concise and effective, while meeting the requirements of financial reporting standards.
- All boards must maintain an effective system of internal control for reliable financial reporting and accounting records.
- The directors should explain in the annual report their responsibility for preparing the annual report, including the financial statements that comply with generally accepted accounting practice.
- Each listed entity should have a clear and robust written internal process for compliance with the continuous disclosure regime. This process should include board examination, at each meeting at least, of continuous disclosure issues and should be published on the issuer's website.
- Every entity should make its code of ethics, board committee charters, and other governance documents readily available to interested investors and stakeholders. This information should be available on the entity's corporate website.

FMA commentary

High standards of reporting and disclosure are essential for proper accountability between an entity and its investors and stakeholders. Accountability is a principal incentive for good corporate governance. Reporting and disclosure encompasses both financial reporting and reporting on other affairs of the entity, including corporate governance structures, systems of control, processes and actions.

Responsibility for financial reporting

The quality and integrity of financial reports are reflected in how understandable they are for users. Legal and regulatory requirements, including the NZX Listing Rules, establish baseline expectations for reporting and disclosure. Good corporate governance includes compliance with these requirements and a commitment to ensuring that investors, stakeholders, or the recipients of public sector reports are sufficiently informed to allow them to assess the entity and the board.

The board is directly responsible for the quality and accuracy of financial reports. This requires it to ensure company records are complete and accurate by adopting appropriate accounting policies and implementing appropriate controls and processes. The audit committee (Principle 3) and independent auditors (Principle 7) make a major contribution. These processes should include certification by the chief executive and the chief financial officer (or equivalent officers). These executives are principally accountable to directors, who have ultimate responsibility for financial reports. Executives' accountability is further strengthened, especially in publicly owned entities, by the CEO and CFO publicly demonstrating their responsibility by certifying the financial statements. Directors retain liability for the financial statements of an entity and should have sufficient understanding to challenge and enquire about the accuracy and completeness of financial reports from management and experts, particularly where financial information does not reflect their understanding of the substance of particular arrangements.

Reporting and disclosure requirements are of most significance for public sector entities and for issuers and listed entities. However, other entities could adopt similar standards in the form and timeframe that best suits their legal form, types of business, stage of development, and also the range of users of their financial reports. We encourage all issuers to see listed entity reporting and disclosure as best practice in the New Zealand environment, to the extent applicable. All entities that have raised money from the public should report to investors on the entity's goals, strategies, position and performance.

Compliance with the continuous disclosure regime

The continuous disclosure regime is a major contributor to higher standards of information disclosure in the listed issuer sector. For listed issuers, compliance with continuous disclosure is a board responsibility. Boards must balance their oversight of continuous disclosure compliance with the requirement to disclose material information 'immediately'. Accordingly, we recommend the board has appropriate policies and procedures, including appropriate delegations, in place to:

- enable timely disclosure where it may not be possible for the board as a whole to be involved in a decision to release material information
- ensure company disclosures are factual and presented in a clear and balanced way that includes disclosure of both positive and negative information
- raise awareness throughout the entity of disclosure obligations, including regular training and reminders, and provide efficient channels to alert management of matters that may require disclosure
- review continuous disclosure compliance at every board meeting
- ensure that directors and officers of the organisation understand their disclosure obligations, and review compliance with those obligations at every board meeting
- ensure that any briefings of analysts or key investors are made in compliance with continuous disclosure obligations and only use publicly available information.

Principle 5: Remuneration

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

Guidelines

- The board should have a clear policy for setting remuneration of executives (including executive directors) and non-executive directors at levels that are fair and reasonable in a competitive market for the skills, knowledge and experience required.
- Publicly owned entities should publish their remuneration policies on their websites.
- Executive (including executive director) remuneration should be clearly differentiated from non-executive director remuneration.
- Executive (including executive director) remuneration packages should include an element that is dependent on entity and individual performance.
- No non-executive director should receive a retirement payment unless eligibility for such payment has been agreed by shareholders and publicly disclosed during his or her term of board service

FMA commentary

Adequate remuneration is necessary to attract, retain and motivate high quality directors and executives. It is generally expected such remuneration will be reflected in enhanced entity performance.

The issues in establishing remuneration are particularly complex and can only be viewed in the context of each entity. It is important that every board has policies and processes for setting remuneration and for remuneration reporting (including disclosures required under the *Companies Act 1993*).

Shareholders of a publicly owned company have a particular interest in seeing that the remuneration policy will attract the right directors, and that the level of remuneration is reasonable. To enable shareholders to assess this, the policy for determining remuneration and how it is set should be disclosed, as well as the total remuneration and a full breakdown of any other benefits and incentives paid to directors.

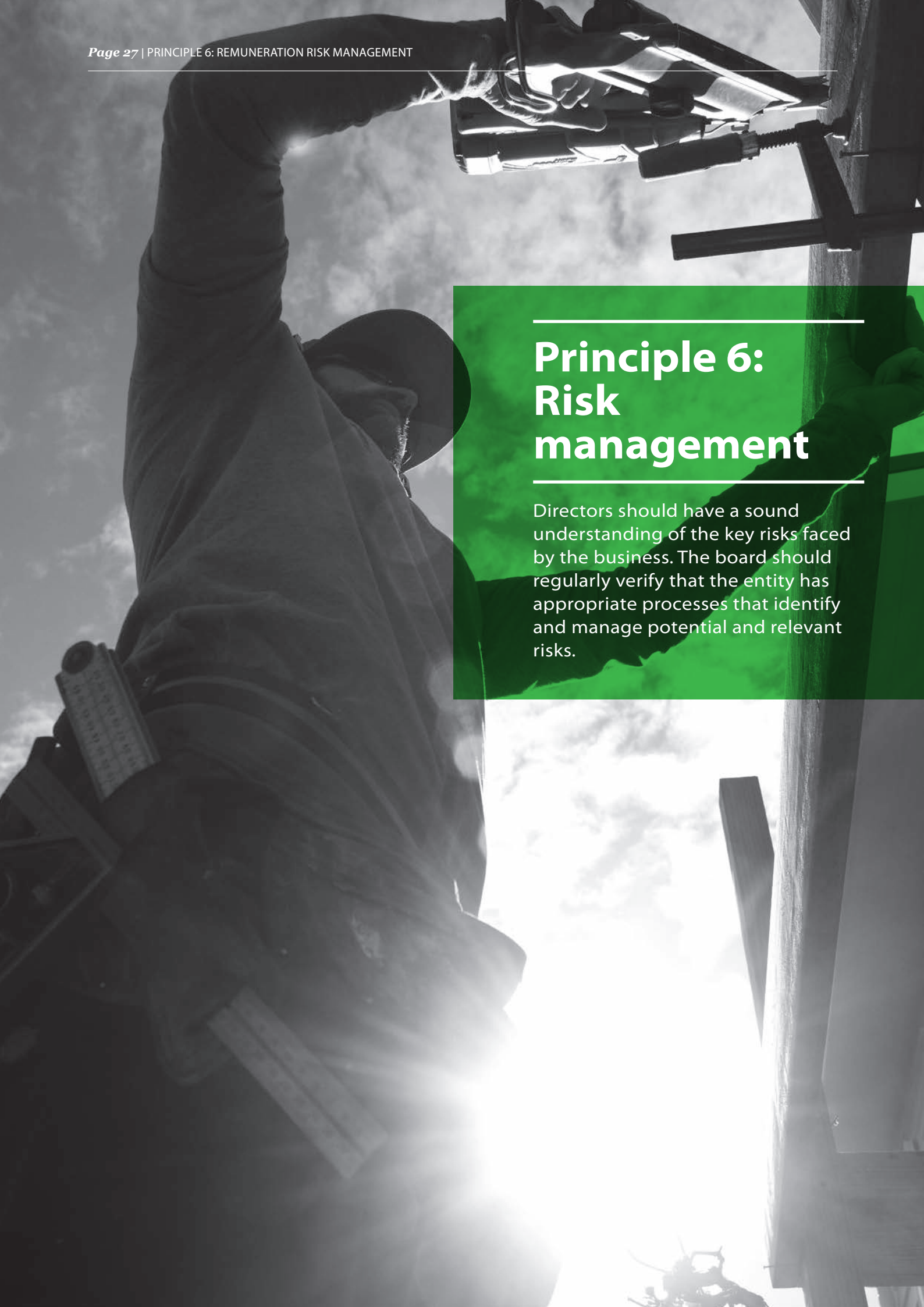
Remuneration for directors and non-executive directors

Executive and non-executive directors have different roles and different incentives. Drawing a clear distinction between the remuneration packages of executive directors and non-executive directors allows entities the flexibility to properly address the circumstances of both.

If a part of executive directors' remuneration is related to entity performance over time, their efforts are more likely to be focused on making a contribution to future investor returns rather than only on short-term gains. Such remuneration may include shares or options.

Non-executive directors' remuneration is usually by way of fees. It is important for accountability of publicly owned entities that all benefits received are disclosed to shareholders. It is consistent with this transparency that non-executive directors should not receive retirement payments except where eligibility for such payments has been agreed and disclosed during the term of service on the board, and in the case of publicly owned entities, where shareholders have been asked to approve these payments.

The commentary in Principle 3 includes information about the benefit of appointing a remuneration committee.



Principle 6: Risk management

Directors should have a sound understanding of the key risks faced by the business. The board should regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks.

Guidelines

- The board should require the entity to have rigorous processes for risk management and internal controls.
- The board should receive and review regular reports on the operation of the risk management framework and internal control processes, including any developments in relation to key risks. Reports should include oversight of the company's risk register and highlight the main risks to the company's performance and the steps being taken to manage these.
- Boards of issuers should report at least annually to investors and stakeholders on risk identification, risk management and relevant internal controls.

FMA commentary

Risk is an essential feature of business. Each entity is faced with a range of risks that it needs to identify and manage (or avoid). Accordingly, risk management is a critical area of responsibility for the boards, which can only be effective if they know of, and can properly assess, the nature and magnitude of risks faced by the entity. Effective risk management can enable an entity to take appropriate risks.

Processes to manage risk

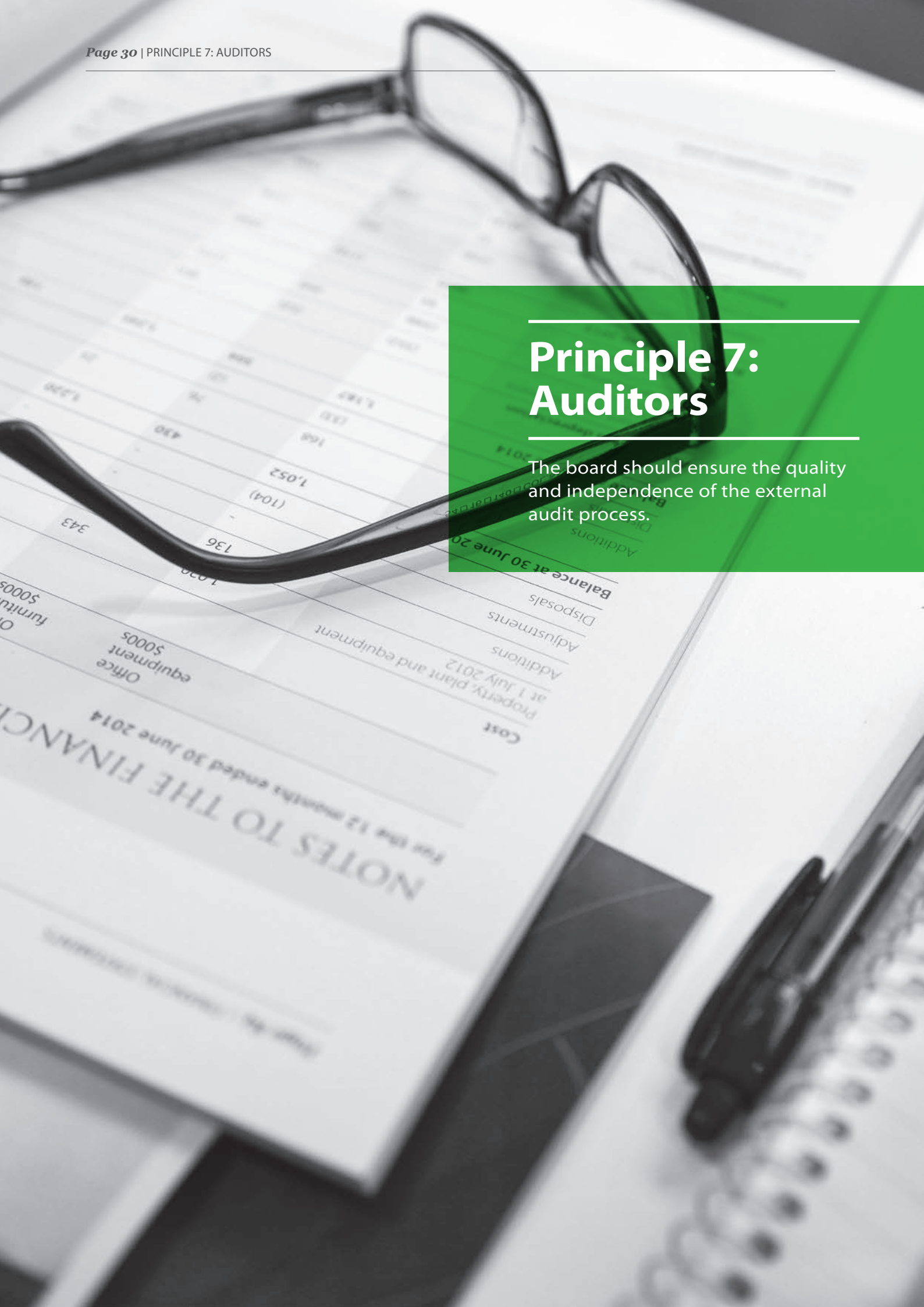
Processes such as enterprise-wide risk management frameworks are useful to identify, monitor and manage risks. This enables the board and managers to be properly informed and to implement internal control systems that are responsive to the risks identified. These processes will usually operate alongside other internal control structures. The size and circumstances of the entity, and the particular risks it faces, will help determine the best risk management processes. This may include a separate risk management function

or committee, depending on the nature, size and complexity of the business. Effective processes will identify the types of risks the entity is likely to face, including legal, compliance, financial, operational, technological, health and safety, and environmental risks. An internal audit function can complement effective risk management and internal control in entities that face significant financial, operating and compliance risks.

Given that risk management is an essential part of business, boards of issuers should report at least annually to investors on the risk management strategy. Reports should detail how the board effectively oversees risk and report on individual strategies to manage any significant risks. The commentary in Principle 3 includes information about the benefit of having a separate risk committee.

Principle 7: Auditors

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



Guidelines

- The board should inform itself fully on the responsibilities of external auditors and be rigorous in its selection of auditors on professional merit.
- The board should satisfy itself there is no relationship between the auditor and the entity, or any related person that could compromise the auditor's independence. The board should require confirmation of this from the auditor.
- The board should facilitate regular and full dialogue among its audit committee, the external auditors and management.
- No issuer's audit should be led by the same audit partner for more than seven consecutive years. For listed issuers, NZX rules require most listed entities' audit partners to be rotated from the engagement after a maximum of five years.
- Boards of issuers and entities that are obliged to prepare and file financial reports under the FMA Act should report annually to shareholders and stakeholders on the fees paid to auditors, and should differentiate between audit fees and fees for individually identified non-audit work (for example, separating each category of non-audit work undertaken by the auditors, and disclosing the fees for this).
- Boards of issuers should explain in the annual report what non-audit work was undertaken and why this did not compromise auditor objectivity and independence. They should also explain the following:
 - how they satisfy themselves on auditor quality and effectiveness
 - the boards' approach to tenure and reappointment of auditors
 - any identified threats to auditor independence
 - how the threat has been mitigated.

FMA commentary

The quality of external auditing is critical for integrity in financial reporting. To properly perform their role, auditors must observe the professional requirements of independence, integrity and objectivity. They need to have access to all relevant information and individuals within an entity that play a role in the financial reporting processes.

The board and the auditors are jointly responsible for ensuring an entity's audit is conducted in the context described above. Good governance requires structures that promote auditors' independence from the board and executives, protect auditors' professional objectivity in the face of other potential pressures and facilitates access to information and personnel.

The role of the audit committee

The audit committee has a crucial role in selecting and recommending board and shareholder appointment of auditors, and in overseeing all aspects of their work. When selecting auditors, boards should ask them whether they have been quality reviewed by the FMA, and if so, whether any issues have been identified and what steps the firm has taken to address these.

Rotation of auditors is important to promote independence and objectivity over time. However, this needs to be balanced against the costs that are necessarily incurred when a new auditor is engaged.

Costs associated with a new auditor are necessarily higher until the auditor becomes familiar with the entity and its business. Retaining a degree of continuity will increase the entity-specific knowledge of an auditor. Professional and ethical standards for auditors require seven-yearly partner rotation (for most NZX listed issuers, five-yearly rotation). This rotation should cover both lead and key audit partners. This will help provide a balance between cost, efficiency and independence.

Non-audit work

Limiting non-audit work from an accounting firm will help maintain independence and objectivity. There is a diversity of views in New Zealand and internationally on the types of non-audit work that should be restricted, and how this should be done. One core measure is that an accounting firm should not undertake any work for an audit client that compromises, or is seen to compromise, the independence, objectivity and quality of the audit process. Given this measure, and within the framework of relevant legislation and professional standards, boards need to consider this in the context of their entity. The quantum of fees paid for non-audit work will be a factor in determining independence. Issuers should focus on improving the disclosure in financial statements regarding non-audit work, and facilitate communication between an audit committee and directors regarding independence in relation to non-audit work.

Auditor independence

Auditor independence is crucial for investors, who rely heavily on this external assurance. Boards are accountable to investors where they allow auditors to undertake non-audit work. This accountability can be achieved by including a statement as to why, in the board's opinion, any non-audit work performed does not impinge on the independence of the auditor. This statement can be included in the company's annual report and should be accompanied by disclosure of all fees paid to the auditor, with various types of non-audit work separately identified, using professional standards.

Dealing with complaints

The audit committee has a crucial role if complaints arise in the auditor-client relationship, or in any other aspect of auditing. The committee should have a defined process for dealing with complaints from auditors, for example over access to relevant information held by management. The committee should also be open to the views of employees or others who believe auditor independence and objectivity is, or might be, compromised. This includes whistleblowing actions by individuals who act in good faith with respect to external and internal audit processes.

The *Companies Act 1993* contains accountability mechanisms that allow auditors to report directly to shareholders where reappointment is not sought, or where the entity seeks to remove an auditor. The board is required to permit auditors to attend annual meetings and be heard. Accountability can be enhanced when boards ask auditors to attend shareholders' meetings and to allow shareholders an opportunity to ask appropriate questions.

Boards should engage with auditors to ensure there is a common understanding and expectation around the scope of audit engagements and the evidence that auditors will expect to be able to find when testing judgments applied to financial statements.



Principle 8: Shareholder relations

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

Guidelines

We encourage widely-held entities to:

- Have clear published policies for shareholder relations and regularly review practices, aiming to clearly communicate the goals, strategies and performance of the entity.
- Maintain an up-to-date website, providing:
 - a comprehensive description of its business and structure
 - a commentary on goals, strategies and performance
 - key corporate governance documents and, if not included in its annual report, a separate section which reports against the entity's adherence to these principles
- all information released to the stock exchange (for listed entities), including reports to shareholders.
- Encourage shareholders to take part in annual and special meetings by holding these in locations, and at times, that are convenient to shareholders and by providing clear and meaningful information about the business to be conducted at these meetings.
- The board should facilitate questioning of external auditors by shareholders during the annual meeting.

FMA commentary

Shareholders are the ultimate owners of entities. In general, company shareholders have a right to vote on certain issues affecting the control and direction of their company. In this document we have used the term 'shareholders' broadly to include people with an ownership interest in non-company entities where they have similar voting rights. The rationale for good shareholder relations applies equally, whatever the legal form of the entity.

The role of shareholders in corporate governance

As owners, shareholders have important rights and functions in corporate governance. Certain matters are reserved for shareholder approval. Boards can take steps to facilitate appropriate shareholder involvement in such meetings and decisions. Entities will be better placed to attract the capital and support they need, and to demonstrate real accountability, if relations between entities and their shareholders are cooperative and mutually responsive.

Good governance requires structures and behaviour that promote good relations through effective communications between entities and their shareholders. All entities, and particularly publicly owned entities, can enhance this relationship by having a policy for communicating with shareholders and for encouraging shareholder participation. Steps that can be taken include:

- making information more accessible to shareholders and others, including email or other electronic means, for efficient distribution of shareholder documents and for responding to questions (where requested)

- giving shareholders sufficient time and detail to enable them to participate in decisions
- holding shareholder meetings in locations and at times that are convenient to shareholders and, if appropriate in view of the number and location of shareholders, encouraging participation by video conference or similar means
- clearly setting out resolutions for shareholder decisions, and encouraging informed use of proxies
- providing ready access to auditors for shareholder questions at annual and special meetings, allocating time and resources to providing clear, plain-language explanations of performance, strategies and goals, and identified material risks in the annual and (for listed entities) half-yearly reports
- actively maintaining websites that have comprehensive, up-to-date information about their operations and structures, key corporate governance documents, shareholder reports, current and past announcements and performance data.

Institutional shareholders have a vital role to play in corporate governance by monitoring company performance. If a disclosure-based approach to maintaining corporate governance standards is to be effective, those with voting power in an entity need to make use of their rights to question and challenge the board's performance and its corporate governance practices. Boards can increase accountability by encouraging all shareholders to vote on resolutions.

Principle 9: Stakeholder interests

The board should respect the interests of stakeholders taking into account the entity's ownership type and its fundamental purpose.

Guidelines

- The board should have clear policies for the entity's relationships with significant stakeholders, bearing in mind distinctions between public, private and Crown ownership.
- The board should regularly assess compliance with these policies to ensure that conduct towards stakeholders complies with the code of ethics and the law and is within broadly accepted social, environmental, and ethical norms—generally subject to the interests of shareholders.
- Public sector entities should report at least annually to inform the public of their activities and performance, including on how they have served the interests of their stakeholders.

FMA commentary

Each entity has stakeholders who contribute in different ways. Examples include employees, customers, creditors, suppliers, the community and others. Legal obligations and relevant social, ethical, and environmental factors need to be taken into account when considering the interests of stakeholders.

Stakeholder interests in public sector entities

Stakeholder interests have a particular significance for public sector entities. These entities operate on public funding, and need to pay careful attention to their public stakeholders. While the principal reporting of most public sector entities is to the Crown, public accountability will be enhanced if they also report each year on how they have served the interests of their public stakeholders.

Good corporate governance and benefits to stakeholders

Company law requires directors to act in the best interests of the company (subject to certain exceptions). However, advancing the interests of other stakeholders, such as employees and customers, will often further the interests of an entity and its shareholders. We encourage listed companies to report on how they have affected their stakeholders.

Good corporate governance practices will benefit stakeholders. Relationships with significant stakeholders can be improved if they are addressed in specific policies which are disclosed and reported on to stakeholders. Managing stakeholder interests should be viewed as simply good business.

