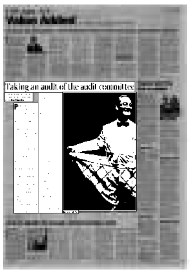

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Taking an audit of the audit committee

Independence in the boardroom it's really not that straightforward writes **Geof Stapledon**

PROPONENTS of good corporate governance are sometimes accused of adopting a "one size fits all" approach. Take as an example the composition of the audit committee. While 15 years ago the debate was whether an audit committee should be necessary in every instance, times have moved on. Now, having resolved that issue in the affirmative, the issue is who should serve on the committee.

The three key sets of guidelines in Australia — those of the ASX Corporate Governance Council, the Investment and Financial Services Association (IFSA) and the Australian Council of Superannuation Investors (ACSI) — all deal with the composition of the audit committee.

The guidelines of IFSA and ACSI, mirroring the listing rules of the New York Stock Exchange, promote an exclusively independent committee: every director who serves on the committee should not only be non-executive, she or he should also satisfy a definition of independence.

The ASX Corporate Governance Council's guidelines take a more liberal approach, saying the committee should be structured so it consists only of non-executive directors, with a majority of those directors being independent.

There is considerable common ground in the definition of independence in the three sets of guidelines. In each case a person who (in his or her "day job") is a material adviser to the company, a material customer of, or supplier to, the company, or a former executive of the company, is considered not to be independent. Also, someone who is a substantial shareholder, or an affiliate of a substantial shareholder, is considered not to be independent.

Many large Australian companies have a substantial shareholder. Examples include PBL (in which the Packer family's Consolidated Press Holdings has a 37 per cent stake), Telstra (in which the Federal Government has a 50.1 per cent stake) and Seven Network (where Kerry Stokes controls 43 per cent of the voting rights). There are many more.

Some of the others include Coca-Cola Amatil (The Coca-Cola Company has a 34 per cent stake), Transfield (Belgiorno-Nettis family interests own 45 per cent) and Minara Resources (formerly Anaconda Nickel, in which the Swiss-based Glencore has a 49.7 per cent stake). What these three companies have in common is an audit committee that includes a non-independent director. In each case, the reason the director is not independent is because of being associated with a major shareholder.

The audit committees of these three companies do not meet the IFSA or ACSI recommendation of 100 per cent independent directors. It does, however, meet the ASX Corporate Governance Council's recommendation of 100 per cent non-executive directors with a majority of them independent.

A case can be made for allowing a major shareholder to have representation not only on the board, but also minority representation on the audit committee.

The rationale would be as follows: the audit committee is the company's key financial oversight committee. A large shareholder would understandably wish to take steps to protect its financial investment. And, provided all other audit committee members are independent (as they are in the three examples cited), having one representative on the audit committee would not enable the major shareholder to control the making of decisions.

However, other shareholders may still have legitimate concerns about a large shareholder representative on the audit committee.

What if that person's presence on the committee makes the external auditor less comfortable about raising sensitive issues — perhaps issues concerning related-party transactions between the listed company and the large shareholder?

It may be possible to take steps to alleviate these concerns. For example, the committee could meet with the external auditor at least once a year without the shareholder representative present.

This would be an extension of what is now a common practice among listed companies — having the audit committee meet the external auditor at least annually without management being present. These meetings are designed to remove any inhibitions the auditor may otherwise have had.

Similarly, a periodic meeting between the external auditor and all audit committee members minus the large shareholder representative should allow the auditor to be frank and open about any issues concerning the shareholder.

None of the three companies mentioned has disclosed any policy or practice along these lines. But this does not detract from the point of principle: although recommended corporate governance practices are in some instances straightforward and not subject to qualification, there will be some circumstances where a degree of flexibility is appropriate.

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Does one size really fit all?