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Corporate Governance and Directors' Duties In Australia



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Australia

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CORPORATE ENTITIES

The main corporate entities in Australia are the private limited company and the public limited company. The legal requirements relating to directors may apply differently to public and private companies and the differences are outlined in the answers below. Corporate governance practice notes and policy statements typically apply to both private and public companies.

REGULATORY FRAMEWORK

1. What is the regulatory framework for corporate governance and directors' duties? Please distinguish, where relevant, between mandatory rules of law and informal guidance/ best practice.

The regulatory framework for corporate governance and directors' duties is governed by the following:

- Statute (notably the Corporations Act 2001).
- Common law rules (for example, cases relating to directors' duties).
- The company's constitution.
- Guidelines issued by the Australian Securities and Investments Commission (ASIC) (known as Practice Notes and Policy Statements). ASIC is a government body that regulates and monitors companies across Australia. These guidelines, although informal, do comply with the Corporations Act and so contraventions of these guidelines may also result in breaches of Australian company law.
- If the company is a listed entity, the ASX Listing Rules (Listing Rules) as published and governed by the Australian Stock Exchange (ASX) provide guidelines on issues such as disclosure.

APPOINTMENT AND REMUNERATION OF DIRECTORS

2. What is the management/ board structure of companies? In particular:
 - Is there a unitary or two-tiered structure?
 - Are employees entitled to have board representation?

- Is there a minimum or maximum number of directors or members of the supervisory and managerial bodies?

- Australian companies have a unitary board structure.
- Employees are not entitled by law to have representation on the board.
- The Corporations Act sets a minimum number of directors, requiring proprietary companies (wholly owned subsidiaries of a public company) to have at least one director and requiring public companies to have at least three directors. There is no statutory limit on the maximum number of directors, although this number may be limited by the company's constitution.

3. Are there any age or nationality restrictions on the identity of directors?

The minimum age for a director is 18 years. There are no age restrictions on directors of private companies (except as provided by the company's constitution). However, directors of public companies must retire at the age of 72 years, unless the shareholders at each successive annual general meeting approve their appointment or continuation. The age restriction applying to directors of public companies also applies to directors of a proprietary company.

While there are no nationality restrictions, the Corporations Act requires that at least one director of a proprietary company must ordinarily reside in Australia. In the case of a public company, at least two directors must ordinarily reside in Australia.

4. Is the role of non-executive directors recognised? If so, what responsibilities should they have and what is the scope of their duties and potential liability?

Non-executive directors are recognised under the Corporations Act and are subject to the same duties and liabilities as executive directors.

While the Corporations Act does not require the inclusion of non-executive directors on the board, independent corporate governance reports (for example, the Bosch Committee, Corporate Practice and Conduct 3rd Ed. 1995) recommend (especially in relation to listed companies) that those boards include a majority

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of non-executive directors with an appropriate mix of skills and experience.

Non-executive directors have a variety of roles including monitoring senior managers and executive directors and developing business strategies. There is a commonly held view that their effectiveness will be enhanced if they are independent of the entity and its management (*Australian Stock Exchange, Guidance Note 9*).

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5. Are there any restrictions on the roles of individual board members – for example, can one person be the chairman and chief executive?
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The roles of individual board members are typically determined by the company's constitution. If the company constitution does not specify otherwise, the Corporations Act provides that a board may elect a director to chair board meetings, and may determine the time period during which the director is to be the chair.

It is possible for an individual to occupy the position of both managing director and chairperson. However, non-binding guidelines issued by independent committees (one from the Bosch Committee, directed primarily at companies listed on the stock exchange, and another from the Investment and Financial Services Association (IFSA), which represents many Australian institutional investors (*Corporate Governance: A Guide for Investment Managers and Corporations 1999*)) recommend that the roles of chief executive and chairperson be separate because the combination of those roles may give rise to conflicts. The committees also recommend (specifically in relation to listed companies) that where the roles are combined, an independent non-executive director should be appointed as a deputy chairman.

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6. How are directors appointed? Is shareholder approval required?
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The method of appointment will generally be governed by the company's constitution. If it is not specified in the company's constitution, the company can appoint a person as a director of the company by resolution of members or alternatively the directors can appoint other directors by a directors' resolution.

In the case of a proprietary company, the appointment of a director by a directors' resolution must be confirmed by a company resolution within two months. ASIC must be notified of the appointment of a director within 14 days.

In the case of a public company, the appointment of a director by a directors' resolution must be confirmed by company resolution at the company's next annual general meeting. In addition to notifying ASIC of the appointment, if the company is a listed entity the ASX requires notice of general meetings proposing the appointment of directors and immediate notification of changes to the board.

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7. Are there any restrictions on a director's term of appointment?
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There are no restrictions imposed by the Corporations Act on a director's term of appointment, apart from the age limit for public company directors. The constitution may require directors to retire by rotation at the company's annual general meeting. However, if the company is a listed entity, the Listing Rules prohibit a director from holding office for more than three years (without re-election). Also, a director who is appointed to fill a casual vacancy in a listed company must not remain on the board for longer than a year. This rule does not apply to managing directors of a listed company.

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8. Is it necessary for directors to be employees of the company? Are shareholders entitled to view their service contracts?
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It is not necessary for directors to be employees of the company. Directors' service contracts do not have to be open to inspection to the shareholders. However, directors may be required to disclose the amount of remuneration paid to them (*see Question 10*).

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9. Are directors permitted or required to own shares in the company?
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The Corporations Act permits, but does not require, directors to hold shares in the company. However, a company's constitution may require a director to own shares in the company. If a director does hold shares in the company, the ASX (if the company is a listed entity) requires disclosure of that interest or any change to that interest.

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10. How is directors' remuneration determined? Does it need to be disclosed to and/or approved by shareholders?
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Determining Remuneration. Directors are entitled to remuneration only as provided for in the company's constitution. If the company's constitution does not make provision for the directors' remuneration, the Corporations Act provides that the remuneration is to be determined by a company resolution. In this case the director may also be entitled to any out-of-pocket expenses incurred in his or her capacity as director. It is possible for either the constitution or the shareholder resolution to delegate to the board the amount and form of remuneration. Excessive remuneration can be challenged under the Corporations Act.

The laws governing single director or single member companies allow for the director to be paid any remuneration as determined by resolution.

Disclosure. A company must disclose the remuneration paid to each director of the company if the company is directed to disclose that information by either:

- Members with at least 5% of the votes that may be cast at a meeting of the members.
- At least 100 members who are entitled to vote at a meeting of the members.

Further statutory provisions (for example, the giving of notice) also govern the manner in which this requirement is to be fulfilled.

In the case of listed entities, the Listing Rules place controls on the total amount that a public company may pay in fees to its directors. The Listing Rules ensure that directors' fees do not include a commission or a percentage of the company's operating revenue.

Directors of listed companies incorporated in Australia are required to provide specific information regarding their remuneration in a directors' report for a financial year.

REMOVAL OF DIRECTORS

11. How are directors removed? Can shareholders remove a director and, if so, what is the process and voting requirements?

A company's constitution will typically provide for the resignation and removal of directors.

In the case of a proprietary company, a board resolution or a member's ordinary resolution (simple majority) may serve to remove a director.

In the case of a public company, a director cannot be removed by other directors. However, an ordinary members' resolution (simple majority) will remove a director from office despite anything in:

- The company's constitution.
- An agreement between the company and the director.
- An agreement between any members of the company and the directors.

In the case of a public company, notice of intention to move such a resolution must be given to the company two months before the meeting, and the director is to be informed as soon as practical after it is received. The director is entitled to put his or her case to members by giving a written statement or speaking to the motion at the meeting.

If the regulatory authority disqualifies a director, he or she must immediately cease being a director. Disqualification is contingent on several requirements listed in the Act

MANAGEMENT RULES AND AUTHORITY

12. How is a company's internal management regulated (for example, the quorum for and conduct of board meetings etc)?

The internal management of the company is regulated by the company's constitution. However, the Corporations Act will govern some matters relating to appointment, remuneration and removal of directors. The quorum for directors' meetings (in public companies) is two directors, unless otherwise provided for in the company's constitution. Similarly, the requirement of a simple majority to pass a directors' resolutions may be altered by the company's constitution.

Numerous sections of the Corporations Act and clauses of the Listing Rules (in the case of a listed entity) govern whether directors are entitled to vote on particular matters. Generally, those provisions prohibit directors from participating in decisions in which they would unfairly benefit.

13. Can directors exercise all the powers of the company? Is it possible to restrict the powers of directors and is any such restriction enforceable as against third parties?

The Corporations Act provides that directors may exercise all of the powers of the company. However, these powers may be restricted by the company's constitution.

People who deal with companies are entitled to assume that anyone who appears to be a director (from company information provided by the company) has been duly appointed and has the authority to exercise the powers and perform the duties customarily exercised or performed by directors at similar companies. However, a person is not entitled to make that assumption if they knew or suspected that the assumption was incorrect.

14. Can the board delegate responsibility for specific issues to individual directors or a committee of directors?

Unless the company's constitution provides otherwise, the directors may delegate any of their powers to a committee of directors, a director, an employee of the company or any other person. The exercise of that power will be as effective as if the directors had exercised it. The directors will be responsible for the exercise of the power.

DUTIES AND LIABILITIES OF DIRECTORS

15. What is the scope of a director's duties and personal liability to the company, shareholders and third parties? Please distinguish between civil and criminal liability under each of the following heads (if relevant):

- General duties.
 - Theft and fraud.
 - Securities law.
 - Insolvency law.
 - Health and safety and environment.
 - Antitrust.
 - Other.
-
- **General duties.** At common law and under the Corporations Act, directors may be liable for civil penalties if they do not:
 - exercise their powers and discharge their duties with the degree of care and diligence of a reasonable person in the same circumstances. The directors' decisions meet the necessary standard if all the following requirements are satisfied:
 - the judgement is made in good faith;
 - the director does not have a material interest in the subject matter of the judgement;
 - they make an informed decision; and
 - they rationally believe that the judgement is in the best interests of the company;
 - manage and conduct the business of a company in the best interests of the company. This is dictated by all the surrounding circumstances including the type of company, its size and the nature of the composition of its board;
 - take reasonable steps to place themselves in a position to monitor management of the company and obtain a general understanding of the business of the company and the effect that changing economic circumstances may have on the business of the company. Accordingly, they are required to attend board meetings and take a diligent interest in the affairs of the company;
 - act in good faith - for the benefit of the company and for proper purposes (directors cannot exercise their powers for an ulterior purpose);
 - avoid situations in which there is real possibility of conflict of interest (*see Question 19*); or
 - properly use information - directors must not use information gained through their position to gain an advantage for themselves or cause detriment to the company.

If a director does not meet these requirements, the courts may make a declaration of a contravention and impose a:

- pecuniary penalty – a monetary penalty up to AUS\$200,000 (US\$110,000);
- disqualification order – to disqualify persons from managing companies; and/or
- compensation order to compensate the company for damage suffered by it.

Under the Corporations Act, directors may be criminally liable if they:

- exercise their powers and discharge their duties recklessly or dishonestly. Directors must not intentionally or recklessly use their position to gain an advantage for themselves or for others, or cause detriment to the company; or
- fail to prepare accurate financial accounts.

If a director is found to be criminally liable, he may be fined up to AUS\$200,000 (US\$110,000) and/or imprisoned for up to five years.

- **Theft and fraud.** A director may be criminally liable under the common law relating to theft and fraud.
- **Securities law.** A director may be held civilly or criminally liable under the Securities Industries Act. Prohibited conduct under that Act includes:
 - making misleading statements in order to induce people to buy or sell shares;
 - engaging in other conduct (market rigging) that would induce people to buy or sell shares; and
 - falsifying records.

Directors may also be held civilly and criminally liable for such conduct under the Corporations Act.

The Corporations Act also provides a prohibition on insider trading. Like the provisions listed above, breaches of the insider trading provisions may result in civil or criminal liability.

- **Insolvency law.** A director may be personally liable if he allows the company to incur a debt while the company is insolvent, or the debt causes the company to become insolvent. If the director is aware that there are such grounds, or the reasonable person would have been so aware, the director will be civilly liable. If the director suspected that the company was insolvent (or would become insolvent) and his failure to prevent insolvency was dishonest, then the director will be criminally liable.

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- **Health and safety and environment.** A director may be civilly and criminally liable for breaches of the Occupational Health and Safety Act and Regulations in certain states.
- **Antitrust.** Under trade practices legislation, directors may be held to be civilly and criminally liable if they breach the provisions of the Trade Practices Act. While the Act refers to a wide range of conduct, the most relevant is that it prohibits conduct that may be classified as “misleading or deceptive”. Directors’ conduct may be deemed to be the conduct of the company, thereby exposing the company to criminal and civil sanctions.
- **Other.** Directors may be civilly and/or criminally liable if:
 - they continue to act as a director whilst disqualified under the Corporations Act; or
 - they destroy or falsify company documents.

16. Can liability be restricted or limited in any way?

Generally, liability cannot be restricted or limited in relation to the issues referred to above (see *Question 15*).

17. Can a director obtain insurance against personal liability and, if so, can the company pay the insurance premium?

A company is able to insure and pay for premiums for its directors on the condition that the insurance policy does not insure against either:

- Conduct arising out of an intentional breach of director's duty to the company.
- A claim for improper use of inside information or position.

18. Are there any circumstances in which a third party (such as a parent company or controlling shareholder) could be held liable as a “director” for the issues identified in Question 15 (even though such person has not been formally appointed as a director)?

“*De facto* directors” and “shadow directors” are recognised in the Corporations Act. “*De facto directors*” include:

- A person who is appointed to the position of a director regardless of the name that is given to their position.
- A person who is not validly appointed as a director but who acts in the position of a director.

A “shadow director” may be defined as a person who is not validly appointed as a director but the directors of the company are accustomed to act in accordance with the person’s instructions

or wishes. However, the extended definition only applies to the provisions for liability of officers, as opposed to other procedural requirements.

TRANSACTIONS WITH DIRECTORS AND CONFLICTS

19. Are there any general rules relating to conflicts of interest between a director and the company?

As fiduciaries, directors must avoid situations in which there is a real possibility of conflict between the director’s personal interests and the company’s best interests. The Corporations Act also prohibits a director from:

- Gaining an advantage for himself or herself or another.
- Causing detriment to the company.

To resolve conflicts of interests, directors are required to give notice of material personal interests in matters that relate to the affairs of the company. The constitution of a proprietary company often relaxes the duty to avoid a conflict or arrangement in which he is interested, as long as notice of the interest has been given. Public companies are not entitled to this exemption.

20. Are there any restrictions on transactions between a company and its directors?

Dealings between directors and a company are governed by statute, common law and the company’s constitution. Interested directors must make full and frank disclosure to the board and take positive steps to protect the company’s interests. Directors must have the fully informed consent of the company when they take out company loans.

A director of a public company who has a material personal interest in a matter may not be present while the matter is being considered at a directors’ meeting or vote on the matter unless specific procedures are complied with. Public companies are generally restricted by the Corporations Act or the Listing Rules (in the case of a listed entity) from entering into uncommercial transactions with directors without first obtaining member approval.

21. Are there any restrictions on the purchase or sale of a company’s shares and other securities by a director?

Directors may be criminally liable if they trade using information that:

- Is not generally available.
- Would have a material effect on the price of the company’s shares or securities.

The director may be civilly liable and may be required to pay compensation for damages suffered by other parties to the transaction.

A director of a listed company must notify the stock exchange of relevant interests in shares or other securities of the company or of a related body corporate. Notification to the stock exchange must occur within 14 days after any change in the director's interest.

DISCLOSURE OF INFORMATION

22. Are directors obliged to disclose information about the company requested by shareholders?

Directors are under no general duty to disclose information about the company requested by shareholders.

23. Are there any circumstances in which directors are required to disclose information about the company (to shareholders and/or third parties)?

Public companies, large proprietary companies and certain other entities are required by statute to prepare financial reports for each financial year. Some entities are also required to prepare half-yearly financial reports. Both yearly and half-yearly reports are to be lodged with the ASIC and also distributed to shareholders. Small proprietary companies only need prepare financial statements under certain circumstances, such as in accordance with a direction given by certain classes of individual shareholders or the ASIC.

Similar rules exist in the Corporations Act for the preparation of directors' reports by companies. The directors' report must refer to general matters, such as the company's present and future operations and specific matters including options issues, indemnities and insurance premiums.

Special disclosure requirements may arise under the following circumstances:

- Where shareholders need information to make individual decisions about their investments, such as during a takeover bid.
- When a general meeting is convened, members are entitled to information about the purpose of the meeting. The Corporations Act imposes special information requirements when a meeting is required to be held for certain purposes, for example to obtain shareholder approval to a related party transaction.
- Prospectus requirements for fundraising.

In the case of listed companies there are mandatory disclosure requirements in the Listing Rules.

COMPANY MEETINGS

24. Is it necessary for a company to hold an annual shareholder meeting and, if so, are there any issues that have to be discussed and/or voted upon?

Every public company (other than a public company that has only one member) must have an annual general meeting to be held:

- At least once in every calendar year.
- Within the period of five months after the end of the company's financial year.

The Corporations Act does not require a proprietary company to hold an annual general meeting.

The Corporations Act does not specifically prescribe issues that have to be dealt with at an annual general meeting, but there are certain routine items of business that need to be covered, including:

- The declaration of a dividend (where that is a function of the general meeting).
- The consideration of accounts and the reports of the directors and auditors.
- The election of directors in place of those retiring.
- The appointment of auditors and the fixing of their remuneration.

If the company is a listed entity, there are additional notice requirements for the holding of an annual general meeting. For example, notice of the annual general meeting must be lodged with the ASX for approval before dissemination.

25. Can shareholders convene a meeting or propose a specific resolution for a meeting (and, if so, what level of shareholding is required to do so)?

Directors must call and arrange to hold a general meeting on the request of:

- Members with at least 5% of the votes that may be cast at the general meeting.
- At least 100 members who are entitled to vote at the general meeting.

MINORITY SHAREHOLDER ACTION

26. What action, if any, can a minority shareholder take if it believes that the company is being mismanaged?

The rights of shareholders against company mismanagement come from the company's constitution, statute, and the common law. In brief, minority shareholders can take one of the following actions – they may:

- Take proceedings against directors for breaches of their duties under statute.
- Take proceedings to prevent the majority shareholders from exercising their voting power improperly, by virtue of the doctrine of fraud on the minority.
- Insist that any alteration of class rights or other rights attached to shares be approved by members of the affected class under statutory protections.
- Enforce their personal rights as members, including their right to enforce the statutory contract and the company's constitution.
- Take proceedings, if eligible, under the statutory derivative action under the company's name.
- Apply for the company to be wound-up on just and equitable grounds if the affairs of the company are being conducted unfairly.
- Seek any of a wide range of remedies for oppressive or unfair conduct.
- Seek relief against corporate misfeasance with the assistance of the court, the ASIC, or (if winding up of the company has commenced) the liquidator.

INTERNAL CONTROLS, ACCOUNTS AND AUDIT

27. Are there any formal requirements/guidelines relating to the internal control of business risks?

In addition to the statutory requirement of keeping and maintaining financial records, there is a common law requirement, as part of the director's duty of care to the company, to establish and monitor appropriate internal control systems.

28. What are the responsibilities and potential liabilities of directors in respect of the company's accounts?

Every company must keep written financial records that:

- Correctly record and explain its transactions and financial position and performance.

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- Would enable true and fair financial statements to be prepared and audited.

The term "financial records" is given a wide definition and they must be retained for at least seven years. A director who fails to take all reasonable steps to secure compliance may be held civilly liable.

29. Is there a requirement for a company's accounts to be audited?

Every financial year, the following entities must have their financial reports audited and obtain an auditor's report:

- Public companies.
- Large proprietary companies.
- In limited circumstances small propriety companies. For example, where a foreign company controls the small proprietary company for all or part of the financial year.

30. What are the formalities for the appointment of auditors? Is there any limit on the duration of their appointment?

The directors of a public company must appoint an auditor within one month of incorporation, unless the company has appointed an auditor at a general meeting. The directors of a proprietary company can appoint an auditor of the company if one has not been appointed in the general meeting.

An auditor appointed by the directors within one month after incorporation holds office until the first annual general meeting. During the first annual general meeting, the company then appoints a new auditor, who holds office until:

- Death.
- Resignation.
- Ceasing to be capable of acting as auditor.
- Removal by ordinary resolution.
- Voluntary winding up of the company.

There are proposals for reforms regarding auditors (*see Question 36*).

31. Are there any restrictions on the identity of auditors?

The Corporations Act sets out the qualifications and requirements for auditors. These include the following:

- An auditor must be a registered company auditor with ASIC. A person can only be registered if he or she meets certain criteria regarding qualifications and experience.
- A person cannot act as an auditor of a company if that person, or corporation, in which he is a substantial shareholder, owes the company or a related company more than AUS\$5000 (US\$2,700). Nor can the person be an officer, or have been an officer of the company or a related company within the last 12 months, or be a partner, employer or employee of an officer or of an officer's employee.
- ASIC has a discretion to refuse to register an applicant who is not resident in Australia.

32. Are there any restrictions (formal or informal) on non-audit work that can be undertaken by auditors for a company?

The current Professional Statement regarding non-audit services performed by auditors is only legally binding on the members of the ICAA and CPAA. The Statement contains suggestions for different categories of non-audit services with the aim of preserving auditor independence. The Statement was revised in May, 2001 and will be mandatory from 31st December, 2003. There are also proposals for reforms regarding non-audit work performed by auditors (*see Question 36*).

33. What is the potential liability of auditors (to shareholders and third parties) if the audited accounts are inaccurate? Can liability be limited or excluded?

Auditors owe a contractual duty to the company for the work they perform and the law imposes a minimum reasonable standard of quality. If that minimum standard is satisfied, the auditor will not be liable for the inaccuracies of the audited accounts. However, auditors may be held to be liable to shareholders and third parties where both:

- The auditors know, or ought to know, the advice or information given will be communicated to the shareholders or third parties in question.
- It is not unreasonable for the shareholders or third parties to act in response to the advice or information.

However, future reforms in this area could lead to auditors being able to limit their liability through incorporation and proportionate liability.

ROLE OF GENERAL COUNSEL AND WHISTLEBLOWING

34. Is it common for the general counsel to be on the company's board or to have a formal role in corporate governance?

The general counsel in Australian companies usually acts in the

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capacity of a company secretary who may or may not be on the board, but is usually present at board meetings. It is not mandatory for proprietary companies to appoint a company secretary.

Company secretaries also have a statutory obligation to ensure that the company complies with certain legal requirements imposed by the Corporations Act.

35. Is there any statutory protection for "whistleblowers" (a person that makes public criminal activity or other serious malpractice within a company)?

There is no current law protecting whistleblowers. However, reforms will be introduced later this year (*see Question 36*) so that employees who report to ASIC can be given privilege and protection.

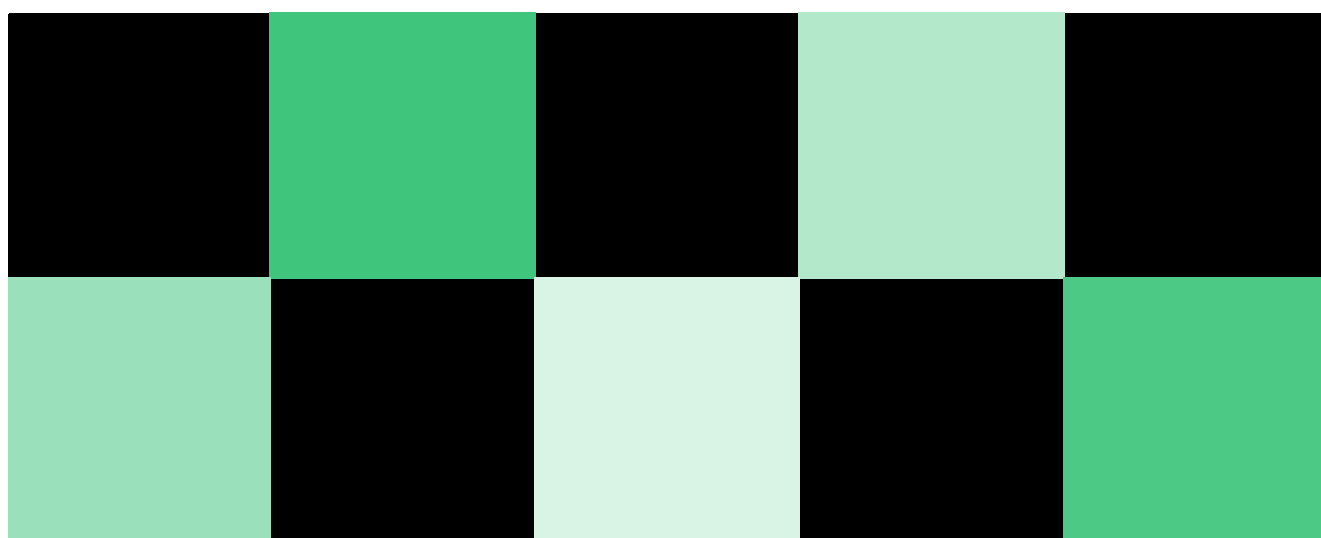
REFORM

36. Please summarise any impending developments in the field of corporate governance and directors' duties.

Recent developments in the field of corporate governance and directors' duties have been proposed in the ninth stage of the Corporate Law Economic Reform Program. Draft legislation is expected to be released by the government for public comment in December, 2002. The proposed changes focus on financial reporting requirements and corporate disclosure. The most significant proposals include:

- Mandatory audit committees for the top 500 listed companies.
- Requirements that the Financial Reporting Council oversee auditor independence.
- Expansion of auditor duties and more stringent requirements for auditor registration.
- Mandatory audit partner rotation after five years.
- Mandatory disclosure in annual reports of fees given for non-audit services by auditors and issuance of a certificate stating that independence has been retained.
- Strengthened restrictions on auditor independence in the areas of employment, financial and business relationships to avoid potential conflicts of interest.
- Adoption of International Accounting Standards for entities reporting under the Corporations Act for reporting periods beginning 1st January, 2005.
- The International Accounting Standards are to have the force of law when adopted by the Accounting Standards Board in the second half of 2003.

- Tougher rules on disclosure requirements of companies.
 - Tougher rules on disclosure requirements for prospectuses.
 - Requirements for directors to disclose details of all directorships currently held and held over the past two reporting periods.
 - Facilitating shareholder participation and information exchange through use of technology including, for example electronic proxy voting.
 - The establishment of a Shareholders and Investors Advisory Council to consult on all disclosure related reforms to ensure they meet the needs of retail investors.
 - An increase in the maximum fine for civil penalty provisions of the Corporations Act from AUS\$200,000 to AUS\$1 million (US\$110,000 to US\$550,000).
 - Civil recovery provisions for breaches of continuous disclosure rules will be amended to clarify that a person may seek compensation regardless of whether the regulatory authority has commenced proceedings.
 - Legal protection for corporate whistleblowers.
- Greater involvement of regulatory and semi-regulatory institutions is expected through the establishment of the Financial Reporting Council, the ASX Corporate Governance Council and the Shareholders and Investors Advisory Council.



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