

## Corporate Governance Principles

In this section, you will find more detailed explanations of James Hardie's governance principles and practices. Further information is also available from the Investor Relations section of the company's website at [www.jameshardie.com](http://www.jameshardie.com)

A summary of the company's approach to corporate governance appears on pages 32-33 of this Annual Report. The Chairman's Report on pages 6-7 also comments on key aspects of our governance policy.

### **New ASX Principles and Recommendations**

On 31 March the Australian Stock Exchange (ASX) Corporate Governance Council released Principles of Good Corporate Governance and Best Practice Recommendations.

ASX-listed companies are obliged to report on whether they follow the recommendations on an "if not why not" basis, for the company's first financial year commencing after 1 January 2003. As James Hardie's fiscal year ends 31 March, it will be required to formally report on the ASX recommendations for its fiscal year ended 31 March 2004.

However, in the interests of good governance and disclosure, we have included comments in this section on whether we met the best practice recommendations for the year ended 31 March 2003 and describe what steps have been taken since or are being undertaken this year in response to the ASX recommendations.

Broadly, James Hardie already complies with the majority of the ASX recommendations. In instances where it does not, this is largely because the company has not previously disclosed an existing practice. This is being addressed.

The company is developing a Corporate Governance section on its website at [www.jameshardie.com](http://www.jameshardie.com) that will be launched and progressively updated this year. It will include more information on the company's governance arrangements and copies of relevant policies and charters.

### **Governance at James Hardie**

As a multi-national organisation, James Hardie operates under the regulatory requirements of numerous jurisdictions and organisations, including the ASX, the Australian Securities and Investment Commission (ASIC), the New York Stock Exchange (NYSE), the US Securities and Exchange Commission (SEC), the laws of The Netherlands and numerous other rule-making bodies.

We think it is important that our behaviour reflects the spirit, as well as the letter, of the law and we aim to govern the company in a way that meets or exceeds appropriate community expectations.

James Hardie's governance framework includes the following key features and practices. These are reviewed regularly and upgraded or changed as appropriate to reflect the company's interests, changes in law and what is generally regarded as sound practice.

### **Board Structure**

James Hardie has a multi-tiered board structure. Consistent with Dutch regulatory requirements, this structure consists of a Managing Board, a Supervisory Board and a Joint Board.

The Managing Board currently includes only executive officers and is responsible for managing general affairs, operations and finance, including the treasury. The Managing Board is chaired by the CEO Mr Peter Macdonald.

The Supervisory Board currently includes only non-executive directors, including the Chairman, Mr Alan McGregor, and is responsible for advising and supervising the Managing Board based on the best interests of the company, including the interests of the shareholders.

The Joint Board currently includes all of the members of the Supervisory Board, ie the Chairman of the Board and the non-executive directors, as well as the Chairman of the Managing Board, ie the CEO. In its role and composition, the Joint Board is James Hardie's equivalent of a full board of directors of a USA or an Australian public company, and is generally referred to as the Board.

The Chairman of the Board must be an independent, non-executive director and cannot be an executive of James Hardie. The Joint Board must always include a two-thirds majority of non-executive directors.

The company's Board structure is consistent with recommendations that form part of ASX Principles 1 and 2.

### **Board Mission and Responsibilities**

A key responsibility of the Board is determining strategy and monitoring company performance. To this end, the company adopts a 3-year business plan and a 12-month operating plan. Financial results and performance are closely monitored against the operating plan.

The Board also ensures that the company has in place effective external disclosure policies and procedures so that shareholders and the financial market are fully informed on all matters that might influence the share price.

The core responsibility of directors is to exercise their business judgment in the best interest of the company and its shareholders. Directors must fulfill their fiduciary duties to shareholders in compliance with all applicable laws and regulations. As appropriate, directors will also take into consideration the interests of other stakeholders in the company, including employees, customers, creditors and others with a legitimate interest in the company's affairs.

In discharging their duties, directors are provided direct access to and may rely upon the company's senior executives and outside advisors and auditors. Board committees and individual directors may seek independent professional advice at the company's expense for the purposes of the proper performance of their duties.

The tables on pages 46 and 47 of this annual report summarise the composition of the company's boards and board committees and each board member's attendance at meetings during the year.

The responsibilities of the Board are consistent with ASX Principle 1.

### Qualifications

Directors should possess qualifications, experience and expertise which will assist the Board in fulfilling its responsibilities, as well as assist the company in achieving future growth. The skills, experience and relevant expertise of each director as well as their term of appointment is summarised on pages 44 and 45 of this annual report and more detailed biographical details appear on the company's website.

Directors must also be able to devote a sufficient amount of time to prepare for and effectively participate in board and committee meetings.

Members of our Supervisory Board, who are elected by our shareholders, and members of our Managing Board (other than our Chief Executive Officer) are elected for a three-year term. In each case, such terms expire at the end of the third annual meeting of shareholders, following election.

The responsibilities of directors and the company's expectations of them are now set out in a letter at the time the director is appointed, consistent with ASX Principle 1.

### Tenure

The Board does not believe that arbitrary limits on the tenure of directors are appropriate or in the best interests of the company and its shareholders. Limits on tenure may cause the loss of experience and expertise that are important contributors to the long-term growth and prosperity of the company. Conversely, the Board does not believe that directors should expect to be automatically nominated for re-election at the end of their three-year term, but that their nomination for re-election should be based on their individual performance and the needs of the company. Under Netherlands' law, directors must retire upon reaching 72 years of age.

### Standards of Performance

There are performance and evaluation processes for directors that are conducted by the Nominating and Governance Committee and these are important factors in determining nominations for re-election as well as for selecting nominees for new directors. The company plans further disclosure in the current year on performance evaluation, consistent with ASX Principle 8.

### Independence

Directors are expected to bring their independent views and judgment to the Board and must declare any potential or actual conflicts of interest.

At least a two thirds majority of the directors must be independent and the office of Chairman and Chief Executive Officer cannot be held by the same person simultaneously other than in special circumstances and/or for a short period of time.

In determining the independence of directors and whether a director has a material relationship with the company or another party that might impair their independence, the Board considers all relevant facts and circumstances, including the following:

- company stock owned, either directly or indirectly by the director;
- compensation received by the director or a family member (other than amounts received for service to the Board);
- employment by the company (or any of its affiliates) of the director or a family member, whether such employment is current or in the past;
- business relationships between (i) the director or a family member or any business entity associated with them and (ii) any of the company's auditors, advisors, vendors, or other business entities or individuals providing services to the company;
- any interlocking board or other company committee relationships; and
- any other direct or indirect relationship between the director and the company that may be material.

The Nominating and Governance Committee reviews the applicable definitions and director independence on a continuous basis.

All of the non-executive directors, including the Chairman, currently meet the independence criteria proposed by the ASX (Principle 2), the SEC and the NYSE.

### Meetings

The Joint and Supervisory Boards generally meet between five and eight times each year and board committees meet as required to fulfill their responsibilities. At each Board meeting, the Supervisory Board conducts sessions without any members of the company's management present.

The Board has an annual program of visiting company facilities and spending time with line management, customers and suppliers to better understand the company's businesses and the markets in which James Hardie operates.

The Audit Committee meets a minimum of once a quarter to conduct business pursuant to its charter, to review quarterly financial results and releases and to discharge its other responsibilities.

### Director Orientation

The company has an orientation procedure for new directors consistent with ASX Principle 8. The company's Chief Executive Officer, Chief Financial Officer, General Counsel and Executive Vice Presidents are responsible for providing information for the orientation for new directors and for periodically providing materials or briefing papers to the boards on such matters as may be requested or appropriate for the fulfilment of the directors' duties.

Typically, a new director will undergo an extensive orientation including:

- visits to company facilities, meetings with management and customers;
- reviews of financial position, strategy, operating performance and risk management;

- their rights, duties and responsibilities; and
- the role of board committees.

Similar induction and orientation programs are in place for executives and employees and are tailored according to seniority and position.

### **Management Succession**

The Board has developed and periodically revises management succession plans, policies and procedures for the company's Chief Executive Officer and other senior officers, whether such succession occurs as a result of a promotion, termination, resignation, retirement or emergency.

### **Compliance, Ethics and Integrity**

The company seeks to maintain high standards of integrity and is committed to ensuring that James Hardie conducts its business in accordance with high standards of ethical behaviour. In 2002, the company revised and updated its already comprehensive Code of Ethics and will continue to do so periodically.

The Board requires that employees comply with the spirit as well as the letter of all laws and other statutory requirements governing the conduct of James Hardie's activities in each country in which it operates.

Specific action, including training and education, has been taken to ensure that employees understand and comply with their obligations in areas such as occupational health and safety, trade practices/antitrust, environmental protection, employment practices such as equal opportunity, sexual harassment and discrimination, continuous disclosure and insider trading, public and SEC disclosure, and corrupt practices.

The company's Code of Ethics is consistent with the recommendations that form part of ASX Principle 3 and Principle 10. A copy of the code will be available from the company's website.

### **Audit Committee**

The company safeguards the integrity of its financial reporting consistent with the recommendations of ASX Principle 4.

#### *Scope*

The Audit Committee provides advice and assistance to the Board in fulfilling its responsibilities relating to the company's financial statements, financial reporting processes, internal accounting and financial control systems, internal audit, external audit and such other matters as the Board may request from time to time.

#### *Composition*

- Membership: The Audit Committee is comprised of at least three members of the Joint Board who are appointed by the Joint Board.
- Independence: Each member is a non-executive director, independent of the company and management.
- Qualifications: All members have sufficient business and financial expertise to act effectively as members of the committee, as determined by the Joint Board.
- Chair: The Chair is nominated by the Joint Board and may not also be the chairman of the Joint Board.

#### *Responsibilities*

- Standards and Quality: The Audit Committee oversees the adequacy and effectiveness of the company's accounting and financial policies and controls, including periodic discussions with management, external auditors and internal auditors, and seeks assurance of compliance with relevant regulatory and statutory requirements.
- Financial Reports: The Audit Committee oversees the company's financial reporting process and reports on the results of its activities to the Joint Board. Specifically, the Audit Committee reviews with management and the external auditors the company's annual and quarterly financial statements and reports to shareholders, seeking assurance that the external auditor is satisfied with the disclosures and content of the financial statements. The committee reviews material accounting policies, any off balance sheet transactions and material litigation on an as needed or quarterly basis. The Chair of the Audit Committee may represent the entire Audit Committee for the purposes of quarterly reviews.
- External Audit: The Audit Committee discusses with the external auditors the overall scope and plans for its audit activities, including staffing, contractual arrangements and fees. It reviews all audit reports provided by the external auditor, including an annual report from the external auditor on its independence. The Committee also specifically approves or establishes approval policies or procedures for any proposed audit and non-audit activity by the providers of the external audit.
- Internal Audit: The Audit Committee discusses with the internal auditors the overall scope and plans for its audit activities. It reviews all internal audit reports.
- Appointment of External Auditor: The external auditor is appointed by the Joint Board. The Audit Committee reviews the performance of the external auditor annually, and can recommend to the Joint Board any changes to the appointment it deems appropriate.

#### *Processes*

- Communications: The Audit Committee maintains free and open communications with the external auditors, internal auditors and management. The Committee periodically meets with the external auditors without representatives of management present to discuss the adequacy of the company's disclosures and policies, and to satisfy itself regarding the external auditor's independence from management.
- Access: In exercising its oversight role, the Audit Committee may investigate any matter relevant to its charter or relating to its role and scope, and for this purpose has full access to the company's records, personnel and any required external support.
- Standards: The Audit Committee reviews, and may take any necessary action to uphold, the overall quality of the company's financial reporting and practices.
- Charter: The Audit Committee reviews and reassesses its charter at least annually, and recommends any changes it considers appropriate to the Joint Board.

## Corporate Governance Principles *(continued)*

- Special Reviews: The Audit Committee may undertake other special duties during the course of the year as requested by the Joint Board.

The external auditor attends shareholder meetings and is available to answer questions from shareholders about the conduct of the audit and the preparation and content of the audit report and the company's accounts.

The company is currently revising its Audit Committee charter and, once adopted, it will be posted on the company's website.

Members of the Audit Committee are Messrs MR Brown (Chairman), MJ Gillfillan, JRH Loudon and AG McGregor.

### Nominating and Governance Committee

The company's Nominating and Governance Committee was formed in 2002 and operates in accordance with recommendations that form part of ASX Principle 2.

The Nominating and Governance Committee's role includes:

- the continuous evaluation and refinement of the company's corporate governance processes;
- the evaluation of individual director performance;
- the evaluation, at least annually, of the performance of each board and its committees;
- the recommendation of candidates for re-election;
- consideration of issues regarding board composition and size; and
- the identification and screening of candidates for election or appointment to the boards.

The company is currently revising its Nominating and Governance Committee charter and, once adopted, it will be posted on the company's website.

Members of the Nominating and Governance Committee are: Messrs AG McGregor (Chairman), GJ Clark, MJ Gillfillan, Ms M Hellicar and Mr JRH Loudon.

### Remuneration Committee

The structure and disclosure of the company's remuneration arrangements is consistent with ASX Principle 9.

To achieve and sustain high performance, the Board believes it is important to attract and retain high calibre employees. The company uses a mix of fixed pay, performance-based remuneration and equity-based remuneration.

In recent years, the use of variable or at risk remuneration has been expanded such that a growing proportion of executive remuneration is at risk and dependent on individual and company performance.

Performance-based remuneration is determined by the extent to which the company's economic profit exceeds the cost of capital and the extent to which the executive contributed to such an outcome.

James Hardie also encourages share ownership by directors, executives and employees to align their interests with those of the shareholders. Executives and

employees participate in share option and share purchase schemes tied to individual and company performance.

The company's share and share option plans operate within limits approved by shareholders and deliver a benefit to executives and employees only if there is a corresponding benefit to shareholders. The Chief Executive Officer's most recent option plans deliver a benefit only if the company's Total Shareholder Return (TSR) exceeds the average TSR for a benchmark group of 100 companies listed on the ASX. The options do not fully vest for three years from the date of grant.

In addition, directors are required to receive at least US\$10,000 of their directors' fees in shares of the company's stock. A retirement plan for directors was terminated in 2002 and directors appointed since then are not entitled to retirement benefits. Three directors had accumulated benefits under the plan that will be paid out when they retire and Australian-based directors still receive government mandated superannuation payments.

The Joint Board has established a Remuneration Committee to institute appropriate controls in the remuneration of senior executives and non-executive directors and to advise it on remuneration policies and practices. The Remuneration Committee's membership is limited to independent directors and its role includes:

- review and approval of the Chief Executive Officer's remuneration package and evaluation of performance each year;
- review and approval of the annual remuneration policy guidelines for other senior executives;
- recommending the granting of stock options or other forms of equity-based compensation;
- approval of any significant changes in remuneration policy, superannuation, or executive and employee incentive plans;
- considering changes in non-executive directors' compensation; and
- overseeing succession planning for senior management positions including the Chief Executive Officer.

The company is currently revising its Remuneration Committee charter and, once adopted, it will be posted on the company's website.

Members of the Remuneration Committee are Mr AG McGregor (Chairman) and Ms M Hellicar. Mr MM Koffel, a consultant to the Joint Board, also serves as consultant to the committee.

### Risk Management

The Board is responsible for satisfying itself that the company's risk management systems are effective and, in particular, for ensuring that:

- the principal strategic, operational and financial risks are identified;
- effective systems are in place to monitor and manage risks; and
- reporting systems, internal controls and arrangements for monitoring compliance with laws and regulations are adequate.

In addition to maintaining appropriate insurance and other risk management measures, the Board has taken the following steps to address identified risks:

- established policies and procedures in relation to treasury operations, including the use of financial derivatives;
- issued and revised standards and procedures in relation to environmental and health and safety matters;
- implemented and maintained training programs in relation to legal issues such as trade practices/antitrust, trade secrecy, and IP protection; and
- issued procedures requiring that significant capital and revenue expenditure is approved at an appropriate level of management or by the Board.

The internal and external audit functions are involved in risk assessment and management and the measurement of effectiveness. The internal and external audit functions are separate and independent of each other.

The above risks are also addressed in the company's Code of Ethics and monitored by regular reports to the Board. Presentations are also made to the Board, and to the Audit Committee during the year, by members of the management team and independent advisers, where appropriate.

The company's risk management procedures are consistent with the recommendations that form part of ASX Principle 7. Instead of one risk management policy, the company has numerous risk management systems and policies that govern the management of risk. The company is reviewing the need for additional disclosure of its risk management systems including that related to its internal compliance and control system.

#### **Certifying Financial Reports**

Under US law, the Chief Executive Officer and Chief Financial Officer certify that the company's accounts are a fair presentation of the company's financial condition and results. This also satisfies recommendations that form part of ASX Principle 7.

#### **Disclosure Policy**

The company complies with all relevant disclosure laws and listing rules in Australia (ASX and ASIC), the United States (SEC and NYSE) and The Netherlands. As it stands, the company's disclosure policy is consistent with ASX Principle 5. However, the company is currently updating its policy and, once adopted, the new policy will be posted on the company's website.

#### **Investor Relations and Communication**

James Hardie is committed to effective communication with its investors and has won a number of awards for investor relations over the past two years. The company's investor relations program includes:

- management briefings and presentations to accompany quarterly results, which are accessible on a live webcast and teleconference;
- webcasts of other management briefings and the shareholder information meeting;

- a comprehensive investor relations website that includes all company announcements and notices as soon as they have been cleared by the ASX, as well as all major management and roadshow presentations;
- site visits and briefings on strategy for investment analysts in Australia and the United States;
- a quarterly newsletter available free to shareholders and other interested parties;
- use of e-mail to alert investors to announcements and other events; and
- equality of access to briefings, presentations and meetings for shareholders, investment analysts and media.

The company's communication strategies are consistent with the recommendations that form part of ASX Principle 6.

#### **Subsidiary Relationships**

The substance of these corporate governance standards applies to all subsidiary companies of the James Hardie group.

#### **Share Purchases by Directors and Senior Executives**

Directors must notify the Chairman before buying or selling James Hardie shares. Purchases or sales of shares can only be made within four weeks beginning two days after the announcement of quarterly or full year results. The Board recognises that it is the individual responsibility of each director and officer of James Hardie to ensure they comply with the spirit and the letter of insider trading laws and that notification to the Board in no way implies Board approval of any transaction. Directors are subject to the company's insider trading policy and rules. The company's policies and rules are consistent with recommendations that form part of ASX Principle 3 and will be available from the company's website.

#### **Responsibilities to Legitimate Stakeholders**

The company's Code of Ethics, referred to above, covers many aspects of company policy that govern compliance with legal and other obligations and is largely consistent with the recommendations of ASX Principle 10. The Code will be available from the company's website, is being revised this year and, once adopted, the revised version will also be available on the website.

#### **Additional Information**

The company is expanding its website to include a dedicated section on Corporate Governance as part of the Investor Relations section of the site at [www.jameshardie.com](http://www.jameshardie.com)

This section will provide more information on the company's governance arrangements including more details about its compliance with the ASX Corporate Governance Council's Principles of Good Corporate Governance that were released in March 2003.

The information on this section of the website will be progressively updated during the year, including the posting of various policies, charters and codes that form part of the company's governance system.