

ASX Corporate Governance Council

Transitioning to the third edition of the Principles and Recommendations



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Outline

- Summary of key changes
- When you have to start reporting against the third edition
- Things you should be doing now to get ready
- Early adoption
- Concluding remarks
- Questions

Key changes

- ✓ Greater flexibility to put your governance disclosures on your website rather than in your annual report
- △ Enhanced risk recommendations (including new recommendations on internal audit and sustainability risks)
- △ Seven other new recommendations to report against
- △ Changes to director independence criteria
- ✓ Board committee recommendations less prescriptive – can have audit, nom, risk and rem committees **OR** disclose alternative governance practices and still report you comply
- △ Modified recommendation on board skills matrix
- △ CEO/CFO declarations required for quarter/half year, as well as full year, financial statements

Key changes (cont.)

- △ Modified recommendations on respecting the rights of security holders
- △ Enhanced commentary on diversity recommendations
- ✓ Simpler and clearer directions for externally managed entities
- △ “If not, why not” corporate governance statement (“CGS”) must be dated and approved by your board
- △ New Appendix 4G (key to corporate governance disclosures) to be lodged with your annual report

Note: detailed summary of changes in ASX roadshow tomorrow. Slides for the roadshow presentation and this presentation available on ASX website:

ASX | Regulation | ASX Compliance | Presentations and webinars

<http://www.asx.com.au/regulation/compliance/presentations-and-webinars.htm>

Effective date of changes

- Third edition and related Listing Rule changes take effect for your first full financial year commencing on or after 1 July 2014, ie:
 - 30 June balance date → report for FY ending 30 June 2015
 - 31 Dec balance date → report for FY ending 31 Dec 2015
 - 31 March balance date → report for FY ending 31 March 2016
- Requirements to:
 - report against third edition
 - date and have your board approve your CGS, and
 - lodge Appendix 4Gtherefore don't apply until 2015/2016, depending on your balance date
- **BUT NOTE**: there are a number of steps you will need to implement beforehand if you want to report in 2015/2016 that you are in compliance with the third edition

Enhanced risk recommendations

Rec 7.1 – risk committees (changed)

- If you have, or intend to have, a committee or committees to oversee risk, check their composition and you have disclosed their charters (Rec 7.1(a))
- If you don't, articulate the processes the board employs to oversee your risk management framework to satisfy itself that it is sound (Rec 7.1(b))
- Consider how your disclosures on these matters might read and whether you should upgrade your processes

Enhanced risk recommendations (cont.)

Rec 7.2 – annual review of risk management framework (changed)

- If you haven't done so already, articulate your risk management framework and review process
- Consider how your disclosures about these matters might read and consider whether they need to be upgraded
- If you don't have such a process currently, institute a process for the board or a committee of the board to review your risk management framework at least annually to satisfy itself that it continues to be sound
- Remember to disclose in your annual report or on your website that the review took place during the relevant reporting period

Enhanced risk recommendations (cont.)

Rec 7.3 – internal audit (new)

- If you have an internal audit function, articulate how the function is structured and what role it performs
- If you don't have an internal audit function, articulate the processes you employ for evaluating and continually improving the effectiveness of your risk management and internal control processes
- Consider how your disclosures on these matters might read and whether you should upgrade your internal audit function/processes

Enhanced risk recommendations (cont.)

Rec 7.4 - economic, environmental and social sustainability risks (new)

- Note definitions of ‘economic sustainability’, ‘environmental sustainability’ and ‘social sustainability’ in glossary to, and definition of ‘material exposure’ in footnote 38 of, the third edition
- Note focus is on investment risks, not environmental or social outcomes
- If you consider you do not have a material exposure to sustainability risks, all you need do is to state that fact
- If you consider you do have a material exposure to sustainability risks, you should disclose what those risks are and how you manage, or intend to manage, them
- This does not require you to publish a sustainability report – but, if you do, you can meet Rec 7.4 simply by cross-referring to that report
- You can also meet Rec 7.4 by cross-referring to relevant sections in your operating and financial review

Other new recommendations

Rec 1.2 – background checks for new directors etc

- Check processes are in place to undertake appropriate checks before appointing a person, or putting forward to security holders a candidate for election, as a director

Rec 1.3 – written contracts of appointment

- Check you have a written agreement with each director and senior executive setting out the terms of their appointment

Rec 1.4 – company secretary

- Review reporting lines and confirm that the secretary is accountable directly to the board, through the chair, on all matters to do with the proper functioning of the board

Other new recommendations (cont.)

Rec 2.6 - director induction and professional development

- Review your program for inducting new directors and satisfy yourself it is sound
- Have the board or nom committee periodically review whether there are any gaps in the skills or knowledge of directors and consider professional development opportunities to fill those gaps

Rec 4.3 - auditor to be present at the AGM

- Will mainly impact entities established outside Australia not subject to ss250PA, 250RA and 250T of the Corporations Act
- Consider how security holders may direct questions to the auditor if they are not able to attend the meeting (see Rec 6.3)

Other new recommendations (cont.)

Rec 6.1 - information on website

- If you don't have a website, get one!
- Review and refresh the materials on your company and its governance on your website, using the commentary to Rec 6.1 for guidance

Rec 6.4 - option for electronic communications

- If you don't have an email address for security holder communications, get one and publicise it!
- If it is a generic email address, make sure someone is monitoring it at least daily
- Confirm with your registry that it gives the option for your security holders to communicate with it electronically

Director independence

- Board or board committee should review the independence of each director against the changes made to Box 2.3:
 - expansion of references to material suppliers and customers to cover other material business relationships, going back 3 years
 - inclusion of ‘close family ties’ to someone not considered independent
 - inclusion of ‘been in role for such a period that independence may have been compromised’

in each case, assessing the materiality of any interest, position, association or relationship to determine whether it might interfere, *or might reasonably be seen to interfere*, with independent judgment

- If a director’s status as an independent director has changed:
 - disclose and explain that change to the market in a timely manner
 - assess the impact of that change on the composition of board committees (do they still have the required number of independents?)

Nom, audit and rem committees

- If you have such committees, check their composition and you have disclosed their charters (Rec 2.1(a), 4.1(a) and 8.1(a))
- If you don't have such committees, articulate the processes you employ:
 - to address board succession issues and to ensure the board has an appropriate balance of skills, knowledge, experience, independence and diversity (Rec 2.1(b))
 - to independently verify and safeguard the integrity of your corporate reporting, including the processes for the appointment and removal of external auditor and rotation of audit engagement partner (Rec 4.1(b))
 - for setting the level and composition of remuneration for directors and senior executives and ensuring it is appropriate and not excessive (Rec 8.1(b))
- Consider how your disclosures on these matters might read and whether you should upgrade your processes

Board skills matrix

- Note change in Rec 2.2 of third edition compared to Rec 2.6 (5th bullet point) of second edition – ‘board skills matrix’ instead of ‘statement as to mix of skills and diversity’
- ‘Matrix’ implies specificity around disclosure of skills, not motherhood statements
- Doesn’t have to be in tabular format – choose a format that you feel best conveys the information
- Can reflect the board’s current mix of skills and diversity or the mix of skills and diversity that the board is looking to achieve
- Disclosure only has to be made collectively across the board as a whole – you don’t need to identify the presence or absence of particular skills by a particular director
- Commercially sensitive information can be excluded

CEO/CFO declarations for interim financials

- Note change in Rec 4.2 in third edition compared to Rec 7.3 in second edition
- Before approving financial statements for any financial period, your board should receive from the CEO and CFO a declaration that, in their opinion:
 - the financial records of the entity have been properly maintained
 - the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the entity, and
 - the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively
- Institute processes to get CEO/CFO declarations in time to table them at board meetings approving any quarterly or half yearly financial statements

Respecting the rights of security holders

Rec 6.2 - investor relations program

- Articulate your investor relations program and how it facilitates effective two-way communication with investors
- Consider how your disclosures on your program might read and whether you should upgrade it

Rec 6.3 - facilitate participation at meetings of security holders

- If you haven't already done so, document the policies and processes you have in place to facilitate and encourage participation at meetings of security holders
- Consider how your disclosures on your policies and processes might read and whether you should upgrade them
- Disclose those policies and processes on your website

Diversity policy and disclosures

- If you are a ‘relevant employer’ under the Workplace Gender Equality Act, you can choose to report;
 - your ‘Gender Equality Indicators’, or
 - the respective proportions of men and women on boards, in senior management and across the organisation
- If you are thinking about the former, note footnote 16 on page 11 of the third edition
- If you choose the latter, you must disclose how you have defined ‘senior executive’
- Note the enhanced commentary on how to define ‘senior executive’ and reassess how you have defined the term
- Note also the enhanced commentary on the meaning of ‘measurable objectives’ and test whether your diversity policy really sets meaningful and measurable objectives

Diversity policy and disclosures (cont.)

- If you want guidance on setting measurable objectives, see:
 - Workplace Gender Equality Agency, *About Setting Gender Targets*: <https://www.wgea.gov.au/learn/about-setting-gender-targets>
 - Women on Boards, *Guidelines for Gender Balance Performance and Reporting*: <http://www.womenonboards.org.au/pubs/guidelines/>
- If you want to lead rather than lag, see:
 - *Male Champions of Change, Accelerating the advancement of women in leadership: Listening, Learning, Leading*: https://www.humanrights.gov.au/sites/default/files/document/publication/2013_AHRC_MCC_accelerating_advancement_women.pdf
 - *Male Champions of Change Raise the Bar on Gender Reporting*: <https://www.humanrights.gov.au/male-champions-change-raise-bar-gender-reporting>

Externally managed listed trusts

- Familiarise yourself with the section in the third edition: ‘The application of the recommendations to externally managed listed entities’
- Note the additional two recommendations that apply to you (an alternative to Rec 1.1 and an alternative to Rec 8.1, 8.2 and 8.3)
- Look at the table at the back of Guidance Note 9, which conveniently summarises how the recommendations apply to you
- Review your governance disclosures against that table

Plan your governance disclosures

- Work out which recommendations in the third edition you intend to follow and what disclosures that will entail (Appendix 4G will help!)
- Work out where you intend to make those disclosures - on your website or in your annual report
- If you are going to put them on your website, map out the user experience:
 - Menu location ('About us', 'Investor centre', 'Information for shareholders')
 - 'Corporate governance' landing page
 - Links to pages with more information (eg director bios, info about board committees etc)
 - Links to relevant documents (eg board committee charters)

Plan your governance disclosures (cont.)

- Remember that you still have to produce a stand-alone CGS disclosing:
 - the extent to which you have followed the Council's recommendations over the reporting period, and
 - separately for each recommendation you haven't followed:
 - the reasons why
 - the period for which it was not followed, and
 - what (if any) alternative governance practices you adopted during that period (LR 4.10.3)
- CGS may incorporate material by reference (eg on your website or in another part of your annual report)
- CGS can be published on your website or in your annual report
- CGS must specify the date at which it is current and state that it has been approved by your board (LR 4.10.3)

If your CGS is on your website ...

- Can be a separate PDF document or just a HTML web page
- Make sure it specifies the date at which it is current and that date is your balance date or a later date (LR 4.10.3)
- Make sure it includes a statement that it has been approved by the Board (LR 4.10.3)
- Remember to include the URL of the web page where it is located in your annual report (LR 4.10.3)
- Remember to lodge a copy of the CGS, current as at its effective date, with your annual report (LR 4.7.4)
- On page 1 of your Appendix 4G, remember to:
 - check the second box to indicate that your CGS is on your website and fill out the URL of the web page where it is located, and
 - include the effective date of your CGS in the following paragraph

If your CGS is in your annual report ...

- Make sure it specifies the date at which it is current and that date is your balance date or a later date (LR 4.10.3)
- Make sure it includes a statement that it has been approved by the Board (LR 4.10.3)
- On page 1 of your Appendix 4G, remember to:
 - check the first box to indicate that your CGS is in your annual report and fill out the page numbers of your annual report where it is located, and
 - include the effective date of your CGS in the following paragraph

Getting board approval for your CGS

- Think about the effective date of your CGS:
 - your balance date?
 - the date the board makes its declaration under s295(4) of the Corporations Act?
 - some other convenient date after your balance date?
- Plan when you will get the board's approval and include this in your board calendar
- Discuss with the board ahead of time the process for obtaining approval:
 - pre-vetting by audit committee?
 - certification by company secretary?
 - sign-off by external counsel?

The new Appendix 4G

- Not a replacement for your CGS
- A verification tool you and ASX can use to confirm you are meeting your corporate governance disclosure requirements
- A key investors and other stakeholders can use to find your governance disclosures
- Also a useful guide to help you map out your governance disclosures
- It looks more daunting than it really is!

Early adoption of website disclosure?

- Only possible if you early-adopt the whole package, that is:
 - report against the third edition of the Principles and Recommendations, and follow ...
 - amended Listing Rule 4.10.3 (ie date your corporate governance statement and have it approved by the board)
 - new Listing Rule 4.7.4 (ie give ASX a copy of your corporate governance statement at the same time as your annual report)
 - new Listing Rule 4.7.3 (ie give ASX a completed Appendix 4G at the same time as your annual report)
- If you don't do **ALL** of these things, you will need to include your corporate governance statement in your annual report, as per the existing rules

Early-adoption of the third edition alone?

- Encouraged and can be done without adopting new LR 4.7.3 or 4.10.3 (ie no need to date your CGS, have it approved by the board or to lodge Appendix 4G)
- Your CGS must be included in your annual report and, technically, report the extent to which you complied with the second edition over the whole of the reporting period
- Simply report in your CGS:
 - the switchover date
 - the extent to which you complied with the second edition in the period up to the switchover date
 - the extent to which you complied with the third edition in the period after the switchover date
- Note that new and amended recommendations in the third edition will likely mean that few will be able to early-report full compliance with the third edition

Early adoption of a specific recommendation only?

- Encouraged and can be done without adopting new LR 4.7.3 or 4.10.3 (ie no need to date your CGS, have it approved by the board or to lodge Appendix 4G)
- Your CGS must be included in your annual report and, technically, report the extent to which you complied with the second edition over the whole of the reporting period
- If you early-adopt a new recommendation (ie no counterpart in second edition), technically, there's no need to mention it in your CGS at all – although you can, if you want, and you probably should
- If you early-adopt an amended recommendation (eg diversity), simply report in your CGS:
 - the switchover date;
 - the extent to which you complied with the recommendation in the second edition in the period up to the switchover date
 - the extent to which you complied with the recommendation in the third edition in the period after the switchover date

Concluding remarks

- No right or wrong answers – just tell your governance story as it is
- Remember the purpose of the recommendations – to ensure that the market receives an appropriate level of disclosure about the corporate governance practices an entity has adopted so that:
 - security holders and other stakeholders can have a meaningful dialogue with the board and management on corporate governance matters
 - security holders can factor that information into their decision on how to vote on particular resolutions
 - investors can factor that information into their decision on whether or not to invest in the entity's securities
- Remember you can always choose not to follow a recommendation and give an “if not, why not” explanation
- Note new version of Guidance Note 9, to be issued 1 July 2014

Thank you

