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Mr Alan Cameron AO
Chair
Australian Stock Exchange Corporate Governance Council
20 Bridge St, Sydney NSW 2000

Our ref ASX feedback 15Nov13

Contact Sally Freeman (03) 9288 5389

15 November 2013

Dear Alan

ASX Corporate Governance Principles and Recommendations 3rd Edition Feedback

Thank you the opportunity to review and provide feedback on the Australian Stock Exchange's (ASX's) proposed 3rd edition Corporate Governance Principles and Recommendations (the Principles). KPMG recognises and promotes the importance of sound corporate governance in protecting the robustness and rigour of Australia's capital markets.

Since the introduction of the Principles in 2003, we have observed the Principles become the benchmark for good corporate governance in Australia amongst both listed and non-listed entities. In this respect, it is critical that the Principles meet their objective of embedding good governance practices that promote both investors' and broader stakeholders' confidence.

It is important the Principles remain:

- Contemporary and reflect current trends in both domestic and global corporate governance. We support the regular ongoing review of the Principles
- Flexible in recognising smaller and multi-national listed entities may adopt alternative practices to achieve good corporate governance outcomes
- Transparent where listed entities have the ability to explain to stakeholders why certain Principles and Recommendations have not been adopted and
- Sustainable and commercial without imposing an unreasonable compliance burden.

There are three Principles and Recommendations we provide specific feedback on:

Principle 1 – Lay solid foundations for management and oversight

We recognise the critical importance of an effective board in promoting investors' interests. A key aspect of an effective board is the regular review of the board's performance and we support this recommendation being carried forward to your third edition.

Principle 4 – Safeguard integrity in financial reporting

We agree the previous edition's recommendation 7.3 on the Chief Executive Officer/Chief Financial Officer's certification on the financial statements fits better with Principle 4. We also acknowledge the importance of sustained financial rigour through out the financial period rather than focusing solely on statutory reporting at the end of the financial year.

Principle 7 – Recognise and manage risk

We a recognise and actively promote the importance of sound risk management and an effective three lines of defence in protecting stakeholders' interests. We believe the current recommendations strike the right balance and would not like to see the Council recommend listed entities disclose their material business risks and mitigation strategies. This extension could involve disclosure of commercially sensitive information.

Many listed entities already have a board level Risk Committee or incorporate risk into the Audit Committee's mandate. The Council's proposed strengthening of its risk management principles and recommendations is strongly supported and reflects current trends in sound risk management and is an improvement on the 2nd edition's recommendation 7.

The inclusion of Recommendation 7.3 is also a welcome introduction recognising the importance of an internal audit function in providing assurance over material business risks.

We support greater disclosure over economic, environmental and social sustainability risks. This is a rapidly evolving area of practice. Our analysis indicates 82% of the ASX100 reported environmental and social sustainability information in either in their 2012/2013 Annual Report or as a separate Sustainability Report.

We do, however, believe greater commentary around the Council's expectations of the level of disclosure would be welcomed by listed entities to provide this Recommendation with a solid foundation.

The Council's proposition to provide listed entities with the flexibility to report their corporate governance disclosure on their website rather than their annual report is a positive development. While not diminishing the importance of the entity's annual report in promoting investor confidence, the website is can be updated on a more regular basis to reflect current practice.

KPMG welcomes the Council's proposed update of the Principles to ensure they remain relevant, reflect current practice and make a positive contribution to Australian capital markets. Thank you for the opportunity to provide feedback and we would welcome the opportunity to provide further feedback or support should you require.

Yours sincerely

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Our ref ASX feedback 22 Nov 13

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22 November 2013

Dear Alan

ASX Corporate Governance Principles and Recommendations 3rd Edition Supplementary Feedback

Thank you for the opportunity to supplement our submission of 15 November 2013 by 22 November 2013. Set out below is that supplement.

As we said in our letter of Friday 15 November 2013, we also thank you for the opportunity to review and provide feedback on the ASX's proposed 3rd edition Corporate Governance Principles and Recommendations (**CG Principles**), which will result in the 3rd edition of the CG Principles being released early in 2014 for adoption for years beginning on or after 1 July 2014.

Our previous letter provided specific feedback on the risk-related CG Principles and Recommendations 1, 4 and 7.

This supplement includes a recommendation regarding corporate reporting, and makes Integrated Reporting (**<IR>**) related comments without making any recommendations thereon. It provides information on progress in <IR> as a framework for corporate reporting and investment analysis. The framework and evidence has developed since the consultation draft of the Integrated Reporting Framework was issued in April 2013. The Council may like to consider whether <IR> can be addressed through the CG principles at some point in the future.

Principle 4 – Safeguard integrity in financial reporting

We recommend the inclusion of commentary in relation to Principle 4 which encourages entities to consider actions to reduce volume and complexity in current voluntary reporting, and also in current regulated reporting (e.g. IFRS-based financial statements) by closely reviewing the application of relevant materiality requirements and taking a fresh look about the clarity and flow of existing reports.

Bearing this in mind and the fact that capital market participants and others focus on a broader information set than financial reports when making their investment decisions, we believe that now is the time for Principle 4 to be re-characterised to broaden the focus from financial reporting to corporate reporting, bringing the full reporting suite of corporate reporting under the principle's safeguard.

The Council's proposition to provide listed entities with the flexibility to report their corporate governance disclosure on their website rather than in their annual report is a positive development. While not diminishing the importance of the entity's annual report in promoting investor confidence, the website can provide more detail on standing data and specific frameworks and charters, as well as be updated on a more regular basis to reflect current practice.

Concluding Remarks

Appendix 1 to this document contains specific recommendations in relation to Principle 4. Appendix 2 analyses the current status of the Integrated Reporting Framework.

KPMG welcomes the Council's proposed update of the CG Principles to ensure they remain relevant, reflect current practice and make a positive contribution to Australian capital markets.

Thank you for the opportunity to provide supplementary feedback and we would welcome the opportunity to provide further feedback or support should you require.

Yours sincerely

Peter S Nash
Australian Chairman

Appendix 1 – Suggested Changes to Principle 4 of the 3rd edition of ASX CG Principles

We recommend that Principle 4 be re-characterised to broaden the focus from financial reporting to corporate reporting. Specifically, we recommend the following changes to Principle 4:

> **Principle 4: Safeguard integrity in corporate ~~financial~~ reporting**
>
> A listed entity should have formal and rigorous processes that independently verify and safeguard the integrity of all corporate ~~financial~~ reporting.
>
> **Commentary**
>
> While ultimate responsibility for an entity's corporate reporting ~~financial statements~~ rests with the full board, having a separate audit committee can be an efficient and effective mechanism to bring the transparency, focus and independent judgement needed to oversee the corporate ~~financial~~ reporting process.
>
> The audit committee should be of sufficient size and independence, and its members between them should have the accounting and financial and other relevant expertise and a sufficient understanding of the industry in which the entity operates, to be able to discharge the committee's mandate effectively.
>
> The boards of smaller listed entities may decide that they are able to oversee the corporate ~~financial~~ reporting process efficiently and effectively without establishing a separate audit committee. If they do, the entity should disclose in its annual report or on its website the fact that it does not have an audit committee and explain the processes it employs that independently verify and safeguard the integrity of its corporate ~~financial~~ reporting (including, but not limited to, the appointment or removal of the external auditor and the rotation of the audit engagement partner).
>
> **Recommendation 4.2:**
>
> The board of a listed entity should, before it approves the entity's corporate reports ~~financial statements~~ for a financial period, receive from its CEO and CFO a declaration that the financial and other relevant records of the entity have been properly maintained and that the financial statements and other corporate reports comply with the appropriate accounting standards and other reporting requirements and give a true and fair view of the financial and operational position and performance of the entity in as clear and concise a manner as possible, and present fairly the entity's business strategy, performance and prospects.

Appendix 2 – Current status of Integrated Reporting

We understand the concerns expressed in the Consultation Paper accompanying the release of the draft 3rd edition CG Principles in August 2013, given that the ASX CGC's Consultation Paper was probably based upon the April 2013 Consultation Draft of the Integrated Reporting (**<IR>**) Framework, the consultation period for which ended at approximately the same date on which the draft 3rd edition of the CG Principles was released.

A significant amount of work on the <IR> Framework, including its design and application in practice, has occurred since April 2013. The consultation comments of 358 largely supportive global responses have now been addressed. Further, the IIRC's April 2013 Consultation Draft did not explain how the experience of the IIRC pilot programme's 100 businesses, and the impact and feedback from the 35 large investor pilots in 2012 and 2013, have been built into the <IR> Framework. Since April 2013, the body of experience has significantly expanded, and will continue to expand. All of these developments are reflected in Version 1 of the <IR> Framework to be released in December 2013.

In particular, the IIRC has taken on board comments made about the need to:

- explain that an integrated report is a separately identifiable communication, but one which may be subsumed into an existing report such as an Operating & Financial Review (**OFR**) in Australia, or be a standalone report; and
- make clear how an integrated report relates to a sustainability report, a confusion that may have led to the draft 3rd edition CG Principles comment on <IR> being located under Principle 7 (Review and Manage Risk, and within that, under a heading of 'ESG Reporting'). That is, there may have been no other obvious place to comment on integrated reporting at that stage.

We consider that the thrust of Principle 4: 'Safeguard integrity in financial reporting' correlates well with the <IR> approach. At the time the CG Principles were drafted in 2003 and updated in 2007, following the accounting scandals of the 2000s, financial reporting was seen to be the major form of corporate reporting and a need was seen to strengthen measures to ensure its integrity. Hence, the present focus of Principle 4 is on financial reporting and processes to ensure its integrity, and not on broader corporate communications that exist and are critical in capital markets today. Principle 4 also focuses on the annual report and how it is published in hard copy or on the corporate website.

Paragraph 88 of the Consultation Paper accompanying the draft 3rd edition ASX CG Principles referred to assurance in relation to <IR>. It is likely that some form of assurance on integrated reports, including possibly reasonable assurance, will be the norm by 2015/16 in some territories. This will be achieved based upon the work currently occurring within the <IR> innovator and early adopter community, and the IIRC working with the International Auditing & Assurance Standards Board on how to bring <IR> assurance within the international auditing standards framework. The Australian Auditing & Assurance Standards Board is playing a leading role in this area.

Set out below is further information in relation to the current status of <IR>, which is arranged as follows:

- What <IR> is and is not - Key characteristics of Version 1 of the <IR> Framework
- The Evidence - Why <IR> is ready for widespread global adoption
- The Opportunity - Why Australia should be a fast follower of the early adopters

<u>What it is and is not - Key Characteristics of Version 1 of the <IR> Framework</u>

The key characteristics of Version 1 of the <IR> Framework to be released in December 2013 are as follows:

1 The Framework **does not require the creation of a new report**. The <IR> should be a separately identifiable communication, but one which can be subsumed into an existing report, such as the OFR in Australia under existing rules and guidance.

2 There is **no requirement** in the Framework, implied or otherwise, **to prepare a sustainability report** unless required by law (not in Australia) or requested by key stakeholders.

3 **Forecasts and projections need not be included in the <IR>.** Also, there is no requirement to look out 8-10 years in an integrated report.

4 Using the six capitals in the <IR> Framework **will not add to the volume and complexity of corporate reporting**. In fact, using the <IR> Framework can be a **primary enabler of cutting the clutter** in existing corporate reporting.

5 There is no **requirement to value any of the six capitals,** including financial capital, in the <IR> Framework. Value is **not defined as the sum of the value of the six capitals**.

6 Version 1 of the <IR> Framework **reflects significant practical experience**.

7 The term ‘material’ is on balance well understood in the reporting community and its application to an integrated report is adequately explained in the Framework.

8 The Framework is designed to deliver an integrated report that is **tailored** to the circumstances of each reporting organisation. Therefore reports for Australia’s many small-cap listed companies are not expected to be onerous or long, but most likely short and clearly aligned to internal management and Board reporting. It will focus on explaining the vital few material and strategic value drivers.

<u>The evidence - Why <IR> is ready for widespread global adoption</u>

The <IR> Framework is ready for widespread global adoption:

- It has been proven to work in practice over an extensive three year global trial.
- <IR> is delivering significant business performance improvements to early adopters in South Africa in the IIRC’s pilot cohort.

- It is under demand from and valued by investors, particularly in early adopter territories such as South Africa.
- In South Africa and among the IIRC's pilot cohort, investors are asking for more assurance on integrated reports to enhance their credibility, and the best fit assurance approach for the integrated reporting framework is becoming apparent through market practice.

There is a significant body of evidence as to the readiness of the <IR> Framework in terms of quality of supply and extent of demand:

Quality of supply of integrated reporting - that is, the ability of Version 1 of the <IR> Framework to provide suitable criteria for integrated reporting, evidencing its ability to underpin improved capital allocation and support reasonable assurance to attest to the credibility of integrated reports:

- It is a **strong framework** with **suitable criteria -** Version 1 of the <IR> Framework will be released in December 2013. The April 2013 Consultation Draft of the <IR> Framework received extensive consultation comment between April and July 2013. The pilot businesses have tested it. The investor network has critiqued it. It can fairly be claimed that Version 1 will have widespread global endorsement.
- It **works in practice -** The IIRC pilot businesses and South African listed public companies have proven that the <IR> Framework can be successfully implemented in practice, and that integrated reporting produces significant business performance improvements as well as excellent and valued corporate reports.
- The <IR> Framework is **fit-for-purpose -** Good progress has been achieved in Australia in OFRs for June 2013 balancing companies under Regulatory Guide 247 *Effective disclosure in an operating and financial review* (**RG 247**), which is consistent in many areas with the <IR> Framework.

Extent of demand for integrated reporting – that is, the ability of Version 1 of the <IR> Framework to provide demand for integrated reporting, evidencing its ability to provide better information (strategic, balanced, forward-looking, concise and focused on matters material to value creation) that investors need to make precise and more forward-looking capital allocation decisions:

- South African **investors value and use** integrated reports - Three years in, investors in South Africa are now demanding deeper and broader assurance of integrated reports given the usefulness of the content for their decision-making needs. They are asking for assurance so that they can be more confident of the integrity of the useful information contained in the <IR>.
- **Business performance improvements -** Management and the boards of IIRC pilot businesses are demanding integrated reporting because of the business performance improvements that adopting <IR> brings; for example, better connecting business units and departments. One of the most mentioned benefits of <IR> is the opportunity it provides to

connect teams from across an organisation, breaking down silos and leading to more integrated thinking[1].

- IIRC **investor network critique -** Investors in the IIRC's investor network have reported that the reports they reviewed were useful in communicating a more holistic view of performance than otherwise found in traditional financial reports; and that these reports provided greater insight into areas such as strategy, risk, governance and the future outlook than in traditional reports. Investors felt that the integrated reports provide a contextual foundation for interpretation and analysis.

The Opportunity - Why Australia should be a fast follower of the early adopters

While remaining critically important in demonstrating accountability for past financial performance and the current financial position, financial reporting is no longer the primary corporate reporting tool underpinning capital allocation that it arguably was in the past:

- Recent US research showed that net assets of S&P 500 companies represented only about 19% of market capitalisation in 2009, compared to 90%+ in the 1970s. Intellectual capital and other intangibles[2] have become much more important to value creation.
- Notwithstanding its lack of breadth of coverage across 'the capitals', not being centred on the entity's strategy and business model and not being forward-looking, financial reporting has still become unwieldy in terms of volume and complexity. There is a need to cut the clutter in existing reporting, and <IR> can be used as an enabler by providing an overarching framework, and a reference point for dismantling volume and complexity from existing reports.
- Major listed public companies no longer seek financial capital only or predominantly through financial reporting, and major investors look to far more than financial reports when they allocate capital to companies and their future investments.

  Investor packs and other forms of voluntary reporting have exploded as key corporate communication tools; investor relations and analysts have become key corporate reporting and communications intermediaries; sustainability reporting has advanced through GRI G4; and social media is increasingly being used as a vehicle of or substitute for corporate reporting.
- Aspects of corporate reporting other than financial reporting have legislative coverage (for example, continuous disclosure and capital raising laws in Australia), but there is no overall framework to underpin or govern the integrity of corporate reporting.

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[1] Refer the IIRC's 'Understanding Transformation: Building the Business Case for Integrated Reporting', which tracks the behavioural changes of businesses on their journey towards Integrated Reporting during the first year of the IIRC's Pilot Programme. http://www.theiirc.org/resources-2/other-publications/building-the-business-case-for-integrated-reporting/ . Other benefits include improved internal processes; better understanding of organisational activities is enabling a more holistic business model and more streamlined communications; increased interest and engagement of senior management in long-term business sustainability issues; better measurement of value to stakeholders of managing and reporting on broader issues.

[2] Capitals other than financial and manufactured capital referred to in the <IR> Framework – human and intellectual capital in particular.

- In Australia, it appears that even within the annual report, the 'front end' (the OFR included in the Directors Report) under the stimulus of RG 247 is becoming a more important driver for providing a detailed analysis of the 'full picture' of an entity's strategy, performance and prospects.

In our view the 3rd edition of the CG Principles would be well informed by the expectations set by RG 247, which notes among other things, that the OFR 'must set out information that shareholders or unit holders would reasonably require to assess an entity's operations, financial position, **and business strategies and prospects for future financial years**' [our emphasis], and that this requirement has been enshrined in Australia's corporations law for many years.

RG 247 highlights the importance of the OFR 'in meeting the information needs of shareholders. While an entity's financial report provides useful information about the entity's financial position and performance, it will rarely provide all of the information needed to readily assess the entity's financial position and to appreciate the underlying reasons for the entity's results. It will also provide little, if any, information about business strategies and prospects relevant to future financial performance.' This is where the <IR> Framework will be particularly useful.