



INSTITUTE OF
**PUBLIC
ACCOUNTANTS®**

Submission on the Review of the ASX Corporate Governance Council's Principles and Recommendations

July 2018

28 July 2018

Members of Council
ASX Corporate Governance Council
PO Box H224
Australia Square NSW 1215

Attention: Mavis Tan

Email: mavis.tan@asx.com.au

Dear Members

Review of ASX Corporate Governance Council's Principles and Recommendations

The IPA-Deakin SME Research Centre (Research Centre) is pleased to respond to the request for comments on the proposed revisions to the ASX Corporate Governance Council's Principles and Recommendations. Please refer to Appendix A below.

The IPA is one of the three professional accounting bodies in Australia, representing over 35,000 accountants, business advisers, academics and students throughout Australia and in over 80 countries worldwide. In 2015, the IPA merged with the Institute of Financial Accountants of the UK to form the largest accounting body representing the small business/SME sectors in the world.

It is prudent for any guidance relied on by professional advisers and listed entities to be reviewed regularly and revised as required. The Research Centre commends the ASX Corporate Governance Council (ASXCGC) for being willing to expose the draft revised Principles and Recommendations to the broader community so that all stakeholders have the opportunity to respond to what are significant amendments to a document that is a cornerstone in the regulation of corporate governance and associated behaviours in Australia.

Please don't hesitate to contact Vicki Stylianou (vicki.stylianou@publicaccountants.org.au or 0419 942 733) if you have any queries or wish to discuss our comments further.

Yours faithfully



Vicki Stylianou
Executive General Manager, Advocacy & Technical
Institute of Public Accountants

Appendix A

Corporate reporting in Australia is governed by standards issued by the Australian Accounting Standards Board (AASB) as well as the *Corporations Act 2001*. The principles of good corporate governance are developed by the ASXCGC and are additional reporting requirements imposed on all entities listed on the Australian Stock Exchange. While the former two focus on providing useful information on financial performance to stakeholders, the ASXCGC focuses on corporate governance and the provision of information to stakeholders demonstrating the effectiveness of an entity's corporate governance regime. The ASXCGC is conducting this review at a time of renewed scepticism about the quality of governance of Australian companies. Media coverage of executive remuneration, poor performance of audit and risk committees and failed internal controls in large listed entities has created an environment where these recommendations require revision and a consideration of their status, application and enforcement.

While many of the changes to the governance principles may have individual merit, the changes also provide the Australian community with an insight that there are lessons to be learned from the various examples of poor corporate behaviour that have emerged as a result of a series of inquiries. The inquiry launched by the Australian Prudential Regulation Authority into the Commonwealth Bank and its governance processes highlighted a range of best practice issues related to the board and committee performance. The report was a reminder to all listed entities that a regular review of governance procedures and processes is essential and that boards must hold management, particularly senior management, accountable for activities related to the management of risk.

Proposed amendments to the Principles and Recommendations are being considered at the same time as the Royal Commission into the financial services sector being presided over by former High Court judge, Commissioner Kenneth Hayne and the completed inquiry by the Productivity Commission into *Competition in the Australian Financial System*. The Hayne Royal Commission has heard evidence of governance and internal control failures within banks and other entities. These are areas directly impacted by the Principles and Recommendations issued by the ASXCGC. Strengthening and further clarifying recommendations – particularly where they may enhance the awareness of board members of critical issues requiring investigation – is essential to meet the expectations of the community. Whilst the ASXCGC should be commended for taking proactive measures to set the bar higher for the conduct of listed entities in the amended guidance, it is difficult to pre-empt and balance this process with the outcomes of the Hayne Royal Commission.

A listed entity has an obligation to make a profit using legal and ethical means to ensure that investors and other stakeholders receive an adequate return on their investment and/or remain interested in engaging with the company. A listed entity's financial performance must also be satisfactory so that benefits are derived on an ongoing basis by investors, employees, potential investors, creditors and suppliers. This objective of achieving a profit and ensuring the entity's operations are sustainable in the long term need to be borne in mind as any new or revised regulations such as the Principles and Recommendations are

exposed for comment. It is important that the ASXCGC continues to recognise the need to assess the costs and benefits of new regulations related to corporate reporting to avoid the diversion of corporate resources into compliance work that could otherwise be directed into areas such as business development. What is of equal importance is for all developers or drafters of regulation including the ASXCGC to weigh up the potential benefits of specific disclosures against the various costs of implementation and ongoing compliance with regulations. The Principles and Recommendations of the ASXCGC should not be an exception to this process.

General remarks about the scope of changes to Principles and Recommendations

The Communique issued by the ASXCGC on 2 May 2018 outlined a series of additional areas that need coverage in what will become the fourth edition of the Principles and Recommendations:

- Social licence to operate;
- Corporate values and culture;
- Whistleblower policies;
- Anti-bribery and corruption policies;
- An apparent slowing in the rate of progress in achieving gender diversity at board level;
- A recommendation from the Senate Economics References Committee for increased guidance around carbon risk;
- Cyber-risks; and
- Other areas for improvement identified by KPMG in a review commissioned by the ASX Education and Research Program on the adoption of the recommendations in the third edition of the Principles and Recommendations.

The fourth edition will feature eight principles and 38 recommendations, which is an increase from the 29 recommendations that were published in the third edition. The additional recommendations are in response to market developments and corporate governance lapses that have been exposed as a result of inquiries and the financial services Royal Commission. However, the IPA questions the need to expand the Principles and Recommendations and believes that less prescription can be achieved by maintaining high level principles rather than attempting to respond to every situation with more prescription. While self-regulatory measures have merit, it is difficult at this stage to determine what changes to existing laws or regulations may be necessary to meet any findings of the Hayne Royal Commission.

The ‘if no, why not’ approach to Principles and Recommendations

Principles and Recommendations issued by the ASXCGC are *recommended* corporate governance practices. The underlying rationale of these principles is that listed entities that

comply with these principles will achieve good governance outcomes¹. Listed entities are encouraged to implement these recommendations but they are not compelled to comply where the board of a listed entity believes specific recommendations may not be relevant to the entity or where the entity complies with the spirit of a recommendation in other ways. Some entities may already have a broad-based risk management policy that deals with a range of issues that include the areas of anti-bribery and corruption for example. It would be redundant for an entity that has already catered for these internal policy matters in a broad-based document to separately reissue these policies. The Principles and Recommendations have technically then, been followed in these particular circumstances because the intent or spirit of the recommendation has been met. Moreover, some companies might have an audit committee that addresses risk issues while other companies have two committees that deal with audit and risk management issues separately. It is clear that a company would comply with the spirit of the recommendations in either case but further clarification may be needed to explain the manner in which compliance is achieved.

Location (web link) of corporate governance disclosures

The Research Centre supports the general guidance provided to listed entities on the options for the disclosure of governance information. The recommendations allow for companies to use both web-based disclosures as well as disclosures of governance information in the annual report. It is important, however, that entities ensure that the location of specific electronic governance disclosures is clearly published in annual reports in circumstances where only limited governance information is provided in the annual reports of a listed entity. While the Research Centre agrees that boards of listed entities should customise the presentation of governance disclosures that accords with their needs, users of information provided by the company need to be able to easily access the material.

Production of corporate reports of high quality and integrity

The board of a listed entity is responsible for ensuring that the financial statements and other accompanying reports prepared for shareholders and signed off by the directors, faithfully represent the financial performance and financial position of the listed entity concerned. It will typically achieve this obligation through an audit committee although such a committee may not exist in each circumstance. The ASXCGC reinforces within the guidance that any listed entity that does not have a formal audit committee, must explain how the functions usually performed by an audit committee are fulfilled. The Research Centre supports the continuation of this part of the principle.

Appropriately prepared, readily accessible and clearly readable periodic reports is one way in which a listed entity is able to fulfil its obligations to its shareholders. Periodic reports are only one part of the equation. Listed entities must also comply with the continuous disclosure requirements on a timely basis to ensure that the market is fully informed.

¹ ASX Corporate Governance Council (2018) Corporate Governance Principles and Recommendations, 4th Edition – consultation draft, Australian Securities Exchange, Sydney.

Other matters for consideration

The recommendations need to be considered in the context of the broader regulatory environment that impacts not only listed entities but not-for-profit organisations and other bodies that have stakeholders. While the intention is to ensure that listed entities provide relevant, reliable and transparent disclosures to listed entity shareholders and potential investors, there is a broader role for the guidance contained in the document. Guidance on disclosure of governance objectives and entity risk management policies that are seen as best practice guidance, would be useful in the context of clubs, associations and similar organisations that have a wide range of stakeholders interested in the governance and performance of an entity. Principles of good governance are universal and are not restricted to one kind of structure or entity. While there are differences between not-for-profit entities, listed entities and other for-profit entities, the fundamental need for stakeholders to be appropriately informed about the governance arrangements, risk management processes and financial performance of various kinds of organisations is the same.

Specific disclosures in the consultation document

Principle 1

Recommendation 1.5

“specifically, whether stakeholders agree with the ASXCGC’s proposal to include as part of recommendation 1.5 a requirement that entities in the S&P/ASX 300 set a measurable objective to have a minimum of 30% of directors of each gender on their boards by a specified date”;

The IPA supports this recommendation and would indeed support an objective of 50% of directors of each gender. Whilst we believe that board directors should be chosen on the basis of individual merit, we are also cognisant of the significant amount of research and literature which points to conscious and unconscious bias preventing a genuine meritocracy from emerging.

Recommendation 1.6/1.7

“whether stakeholders agree with the annual timeframes proposed for board reviews in recommendation 1.6 and management reviews in recommendation 1.7”

The recommendations related to board and management reviews are supported. Periodic reviews of the performance of board members and senior management are consistent with industry best practice but the reviews need to be conducted with objective criteria.

Principle 2

Recommendation 2.3

1. *“whether stakeholders agree with ASXCGC’s proposed changes to box 2.3, setting out the factors relevant to assessing director independence”*

The thrust of the changes is to identify those directors who would be considered independent of management or company officers. The changes recommended in Box 2.3 – *“Factors relevant to assessing the independence of a director”* adequately address this issue.

2. *“whether the proposed amendments to principle 3 and the accompanying commentary deal adequately with governance-related concerns related to an entity’s values, culture and social licence to operate”*

Principle 3

Instil the desired culture

The ASXCGC has sought to make substantial revisions to Principle 3 and accompanying recommendations. These changes are in part a recognition that there has been a heightened level of scepticism about the quality of governance that exists on the boards of some listed entities. This is arguably, the result of the publicity generated by the failure of the respective boards of AMP Ltd and the Banks to adequately monitor and control aspects of the behaviour of employees, including senior management. This issue was revealed in the Hayne Royal Commission, as well as separate inquiries that relate to the inappropriate conduct of financial institutions and similar entities involved in the financial services sector. The principle previously read that “a listed entity should act ethically and responsibly”. This has been amended to ensure that it clearly states that “a listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and in a socially responsible manner”. The emphasis on acting “lawfully, ethically and in a socially responsible manner” is reinforced in Principle 3 by commentary that states that listed entities operate with a social license that is threatened by behaviour that is perceived to violate those three values.

It is noted that Principle 3 refers to a broad range of stakeholders that are affected by a listed entity’s behaviour in the conduct of its business. These stakeholders include employees, customers, suppliers, creditors, regulators, consumers, taxpayers and local communities in which the listed entity is based. The draft principle states that there are several ways in which a listed entity may effect its social license to operate – be a ‘good corporate citizen’; - to its stakeholders. These include² but may not be limited to:

- Respecting the human rights of its employees, including paying a “living wage” to employees and not employing bonded, forced or compulsory labour or young children, even in jurisdictions where that may be lawful;
- Maintaining a safe and non-discriminatory workplace;

² ASX Corporate Governance Council (2018) Corporate Governance Principles and Recommendations, 4th Edition – consultation draft, Australian Securities Exchange, Sydney

- Offering employment to people with disability or from socially disadvantaged groups in society;
- Dealing honestly and fairly with customers and suppliers;
- Not engaging in aggressive tax minimisation strategies;
- Not dealing with those involved in or who finance crime, corruption, human conflict or terrorism;
- Acting responsibly towards the environment; and
- Only dealing with business partners who demonstrate similar lawful, ethical and socially responsible business practices.

The objective of ensuring a listed entity reflects the values the ASXCGC embedded in the third principle can be met by ensuring that a listed entity has an appropriate statement of core values that is disclosed to internal and external stakeholders. The principle states that listed entities should have a code of conduct, a whistleblower policy, an anti-bribery and corruption policy.

A listed entity may also have regard to the United Nations Sustainable Development Goals (SDGs) which provide a high level and aspirational framework against which to develop and assess their values and corporate social responsibility initiatives. It is also a credible means of seeking to satisfy the 'social licence to operate' which may otherwise appear ambiguous and uncertain. The SDGs provide a recognisable and consistent framework within which to operate.

As part of the accounting profession, the IPA subscribes to the view of the International Federation of Accountants (IFAC) that accountants have the 'opportunity and obligation to keep business and government on track to support and progress nearly half of the SDGs' (Russell Guthrie, IFAC, reported in Forbes March 2018). Eight of the 17 goals are directly supported by the work of accountants. These include, gender equality, quality education, economic growth, access to justice and strong institutions.

The SDGs overlap with the Principles in that both have the objective of promoting transparent governments and corporations, as well as justice systems and overcoming fraud and corruption in order to promote business and economic growth. For instance, in *The Sustainable Development Goals Report 2018*, it was reported against Goal 16 that almost one in five firms worldwide report receiving at least one bribery payment request when engaged in regulatory or utility transactions.

The IPA contends that the SDGs should be included as a worthwhile framework, which can be applied by aligning the SDGs with materiality and core business strategy; aligning partnerships along supply chains; and measuring and reporting progress against SDG targets and indicators. Some listed entities are already reporting against the SDGs and we believe that this number will grow over time.

General Statement 1

“whether compliance with any of the new or amended recommendations might have any unforeseen consequences or give rise to undue compliance burdens for listed entities”,

A board of directors has two major functions: firstly, it must direct the entity so that it performs successfully in all aspects discussed in the draft documents; for example, satisfying the needs of all stakeholder groups. Secondly, it must comply with all of its responsibilities from both a legal and social perspective. The Principles should recognise the impact of compliance costs as far as possible and consider ‘easy to implement measurements’ which produce cost-effective results. For example, recommendations 1.6 and 1.7 involve what may become qualitative measures which in turn may not provide any information that can be used to effectively improve the governance of the firm. An adverse judgement about a director must, from a natural justice perspective, be subject to an objective review/right of reply which leads to another potentially subjective result with significant disruption to the boards functioning.

General Statement 2

“whether the level of guidance in the draft fourth edition is appropriate and whether stakeholders would like more guidance on any particular principles or recommendations”

As noted above, our preference is to have a shorter document rather than a longer document as proposed, and that guidance should be balanced between a high level approach and an application approach.

General Statement 3

“Whether there are any other gaps or deficiencies in the Principles and Recommendations that have not been addressed by the proposed changes in the consultation draft of the fourth edition”

1. Recommendation 4.4 requires listed entities to disclose processes that it has in place to validate the accuracy, balance, understandability and the decision usefulness of reports provided to investors. This recommendation requires the listed entity to disclose the reporting frameworks that the entity uses to explain its operations and performance to investors and other stakeholders. There are a range of different frameworks that could be used by a company such as Balanced Scorecard, Global Reporting Initiative guidelines and Integrated Reporting. Investors and other stakeholders must be fully informed of relevant frameworks against which the listed entity is assessed so that they can understand the basis of preparation. This is consistent with the logic that is applied in the preparation and presentation of financial statements. The basis of preparation and presentation must be outlined for investors to be able to have some understanding of the framework against which the listed entity is reporting.

2. Principle 2: "*Structure the board to be effective and add value*" predominantly discusses the expected characteristics of directors. This discussion does not address the success factors for the behaviours for incumbent directors, for example, timely decision making, collegiality, respectful and inclusive discussion of the issues under consideration. Such behaviours will reduce the likelihood of divisive conflict between board members, will facilitate effective direction for the firm's strategic implementation and will maximise value add.