

15 November 2013

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By email – [mavis.tan@asx.com.au](mailto:mavis.tan@asx.com.au)

Dear Mavis

### **Proposed 3<sup>rd</sup> Edition, ASX Corporate Governance Principles and Recommendations**

Thank you for the opportunity to comment on the Proposed 3<sup>rd</sup> Edition of the ASX Corporate Governance Principles and Recommendations.

#### **About us**

The Institute of Internal Auditors (IIA) internationally is the peak body for internal auditing. Established in 1941, the IIA is an international professional association with global headquarters in the USA. The IIA is the Internal Audit profession's global voice, recognised authority, acknowledged leader, chief advocate, and principal educator. Generally, members work in internal auditing, risk management, governance, internal control, information technology audit, education, and security. Globally the IIA has more than 180,000 members around the world.

IIA-Australia has been a member and active contributor to the ASX Corporate Governance Council since its inception. IIA-Australia has over 3,000 members, a significant portion of whom are employed by or actively providing internal audit services to ASX Listed entities. This includes the majority of Chief Audit Executives of ASX Listed Entities.

We have pleasure in providing IIA-Australia's submission on this important paper. This submission has been based on consultation with our members.

#### **Summary of key matters**

Our submission focuses on the proposed changes in relation to IIA's core areas of expertise – internal audit, risk, fraud and corruption prevention.

We support the vast majority of changes proposed.

Our substantive comments are as follows.

## **Escalation of Internal Audit to a recommendation**

An effective, independent internal audit function is critically important to the governance of any listed entity.

For most listed companies Internal Audit is the only standing assurance function that is independent of management and can be directed by the Board to provide a program of independent assurance on key matters – commonly referred to as the third line of defence.

It is also the mechanism by which boards receive independent assurance over the adequacy and effectiveness of the organisation's system of risk management and internal control. This was formally acknowledged in the 2<sup>nd</sup> edition of the ASX Corporate Governance Principles and Recommendations in early 2007. As such, Internal Audit is a cornerstone of effective governance and oversight by listed entities.

The global financial crisis identified weaknesses in risk management and risk oversight. International regulators' focus has tended to be on practical matters including assurance over these aspects.

It is for this reason in a number of jurisdictions the requirement for internal audit has been elevated by way of listing rule or statute for listed entities and is no longer left at the whim of an *if-not, why-not* disclosure.<sup>1</sup>

IIA-Australia has been concerned for many years that a surprisingly large number of listed companies have operated without an internal audit function.<sup>2</sup> We are also aware that in a surprising number of listed entities, including very large listed companies, there has not been a commitment to an appropriately resourced, effective internal audit function that is independent from management.

In the Australian context where members of the public are often captive shareholders through their superannuation, such poor governance is an unacceptable outcome. Absence of an independent internal audit function reporting to an appropriately composed board audit committee is correlated with poor performance in risk management, internal control and fraud prevention.

IIA-Australia has been on the record about these matters for a number of years.

We are pleased that internal audit has been escalated to a disclosure requirement in the consultation draft, however this needs to go further to bring the Principles and Recommendations in line with comparative practice internationally. Details are included in this submission.

We are hopeful that an *if-not, why-not* requirement will prompt lagging companies to find their own way through this and develop an approach to internal audit that works for them. Hence we are happy to support the requirement being included as a recommendation of Council and not as a Listing Rule.

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<sup>1</sup> For example - NYSE, KLSE, and APRA listed entities in Australia

<sup>2</sup> Research by Regnan in 2010 indicated that less than 80 per cent of the ASX 200 companies disclosed they had an internal audit function. Based on IIA-Australia's research the percentage drops rapidly outside the ASX 200.

However, if the *if-not, why-not* approach as proposed in recommendation 7.3 is not successful, then it is our view that an amendment to the ASX Listing rules would be in the best interests of security holders and good governance of listed entities.

### **Other key points**

1. Internationally, the nexus between remuneration and excessive risk taking was a key area of focus for governance reforms internationally. While this does not appear to have been as significant an issue in Australia, it does not mean that we are immune and hence is deserving of further consideration.
2. In attempting to deal with broader social and ethical issues, the intentions of principle 3 around fraud, misconduct, inducements and corruption may have been diluted. Given recent public issues with international incentive payments it may be appropriate that this principle be amplified.
3. The inclusion of recommendation 4.1(b) may have unintended consequences by providing a lesser path than fulfilling the full roles of a contemporary audit committee. This should be rectified.
4. We do not support the removal of the requirement for management to make representations to the board on the adequacy of internal controls around financial reporting (revision of recommendation 7.3). This is now a long standing practice and a cornerstone of most comparable codes and listing rules.
5. There appears to have been a blurring of the three lines of defence in the proposed wording within Principle 7. We believe users would benefit from a clear delineation of these functions.

### **Non-substantive but important language suggestions**

In our experience, precision with language, particularly technical language can be very important to assist listed entities with interpretation and implementation. We have made a number of suggested wording changes to improve clarity, and align with accepted local and international standards. These are generally matters of nuance and not substantive in nature.

### **Specific questions asked in the consultation draft**

IIA-Australia's views in relation to the specific questions in the consultation draft are as follows:

*Whether stakeholders support the move by the Council to afford greater flexibility to listed entities to make their corporate governance disclosures on their website rather than in their annual report*

We support the ability of listed entities to make supplemental corporate governance disclosures on their website. We would expect listed entities to already have this practice in place when information has changed since the date of the annual report.

Bundling corporate governance information in the entity's annual report does however serve three important purposes:

1. It provides a single compendium of the critical information for investors and other stakeholders in a single source.
2. It provides a statement of record at a particular point in time.
3. Notwithstanding the requirements of the relevant Listing Rule, by its nature, the annual report is likely to be subject to greater scrutiny and review by the Board than the information on the entity's website.

For these reasons while we support the ability to provide *additional information* on the entity's website, we are not yet convinced that flexibility to *move significant information* from the annual report to the corporate website is in the best interests of shareholders and other stakeholders.

*Whether the structural changes proposed to the Principles and Recommendations particularly, will make it easier for listed entities to understand and report against the Principles and Recommendations*

We do not have a firm view on this, however note that the Guide to Reporting was useful for many entities, and hence a checklist or similar may still be useful as an appendix or supplementary document.

On behalf of IIA-Australia and its members, I would like to thank the organisations and their representatives on Council for their significant contributions to this important group. It is IIA-Australia's view that Council has made a significant and positive effect to good governance, not only to the listed sector, but that its impacts have also had a ripple effect across other sectors and internationally. It has done this in a manner which has brought stakeholders onside and made a very positive contribution. This work is to be commended.

We have provided detailed commentary under each of the principles and recommendations in the attached pages. If you would like to discuss any aspect of the IIA-Australia submission, please contact Todd Davies on 02 9267 9155 or email us at [technical@iia.org.au](mailto:technical@iia.org.au).

Yours sincerely



Peter Jones  
Chief Executive Officer

Attachment  
IIA-Australia detailed submission points

## Proposed 3<sup>rd</sup> Edition, ASX Corporate Governance Principles and Recommendations

Detailed submission from the Institute of Internal Auditors–Australia.

### The linkage with ASX's Listing Rules

Additional guidance required	Some of the language is likely to overwhelm users who are new to the area. This section may benefit from a Plain-English review.
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### Principle 1 - Lay solid foundations for management and oversight

Expanded definition of Principle 1	Agree
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### Recommendation 1.1 – Board Charter

Revised wording of Recommendation	Agree
Potential unforeseen consequences or compliance burdens	The recommendation requires the use of a charter.  If a company uses a document other than a charter to achieve this recommendation, they will not comply with the recommendation. (The current edition provides for a formal statement in a form other than a charter).

### Recommendation 1.2 – Director checks

Inclusion of new recommendation	Agree
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### Recommendation 1.3 – Director and Senior Executive agreements

Elevation of existing guidance to a recommendation	Agree
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### Recommendation 1.4 – Company Secretary

Elevation of existing guidance to a recommendation	Agree
Potential unforeseen consequences or compliance burdens	In our experience, Boards can be uncomfortable with having executives reporting directly to them organisationally, and appropriately so.  While the current guidance is clear, it may be useful to clarify the notion of "direct reporting line" to allay any concerns or unintended consequences.  This arrangement has many parallels with the generally accepted practice for the head of internal audit reporting to

	<p>the board audit committee. We have extensive guidance in this area that may be of assistance and would be happy to provide this on request.</p>
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**Recommendation 1.5 – Gender diversity**

<p>Relocation to Principle 1</p>	<p>Disagree</p> <p>IIA-Australia believes that diversity in its broadest form is important to informed decision making, and avoiding blind-spots by the board, particularly in relation to material risk.</p> <p>In our view, this recommendation sits most accurately in Principle 2 – structure the board to add value.</p> <p>We do acknowledge that there are arguments for location under other principles, including Principle 1 and 3.</p>
<p>Potential unforeseen consequences or compliance burdens</p>	<p>IIA-Australia has consistently argued for diversity to be considered holistically and to include, but not be limited to gender.</p> <p>While IIA-Australia acknowledges the need to address particular imbalances around gender diversity, and supports this being addressed on a proactive basis, we would prefer to see an emphasis on the entity’s approach to diversity in a broader sense, and then to gender diversity specifically, rather than only addressing gender diversity.</p> <p>The explicit focus and reporting trigger solely on ‘gender’ sends a message that gender is more important than other fundamental tenets of intellectual diversity, age, professional background, cultural background or other matters. It is IIA-Australia’s view that diversity in its broadest sense reduces the chances of “groupthink” by boards and management teams, and hence allows for a more whole sighted view of external conditions and lead risk indicators.</p> <p>We note that both the disclosure trigger and supporting detail only relates to gender diversity, whereas Box 1.5 relates to diversity as a whole.</p> <p>Focusing on a single area of diversity also opens up the need for other diversity issues to be tackled on a case-by-case basis in future revisions. We do not believe that this is productive or</p>

	<p>useful.</p> <p>We also note that the commentary to the 2010 Principles and Recommendations starts with the following sentence, which had been deleted in this discussion draft.</p> <p><i>Diversity includes, but is not limited to, gender, age, ethnicity and cultural background.</i></p> <p>We recommend that it remain or be expanded in this release.</p>
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**Recommendation 1.6 – Board and director evaluation**

Consolidation of existing recommendations	Agree
Gaps and deficiencies	The method of this assessment should be expressly disclosed as this provides weight to the credibility of the assessment.

**Recommendation 1.7 – Senior executive evaluation**

Consolidation of existing recommendations	Agree
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**Principle 2 – Structure the board to add value**

Rewording of Principle 2	Agree
Gaps and deficiencies	Board diversity – see comments in section 1.5 above.

**Recommendation 2.1 – Director disclosures and independence**

Consolidation of existing recommendations	Agree
Enhanced disclosure of specific interests in 2.1(b)	Agree
Updated box 2.1	Agree
Gaps and deficiencies	<p>IIA-Australia believes that the holding of a significant parcel of securities in the listed entity, or a highly leveraged parcel of securities (by derivatives, margin loan or otherwise) that is material to a Director, can impair a Director’s independence.</p> <p>Such an arrangement is believed to have been an important contributor to high profile corporate governance issues</p>

	<p>internationally, particularly when members of the audit committee held such interests.</p> <p>IIA-Australia believes this is an important addition to box 2.1.</p>
Potential unforeseen consequences or compliance burdens	<p>We are acutely aware that disclosure of the nature of a leveraged interest could result in undesirable consequences for security holders and the entity itself.</p> <p>The current wording of recommendation 2.1(b) could require such a disclosure by proactive entities even if box 2.1 is not modified.</p> <p>IIA-Australia believes that a transition period may be appropriate to allow Directors to unwind such interests if required in a matter that does not adversely affect the security price or result in an unreasonable impact on those Directors.</p>

### **Recommendation 2.2 – Director disclosures and independence**

No change from previous recommendation 2.1	Agree
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### **Recommendation 2.3 – Independent chairman of the board**

Consolidation of existing recommendations 2.2 and 2.3	Agree
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### **Recommendation 2.4 – Nomination committee**

Consolidation of existing recommendations 2.4 and disclosure element of recommendation 2.6	Agree
Gaps and deficiencies	<p>We would support <i>all</i> members of the nomination committee being non-executive directors as well as the majority being independent directors. Not having this in place has been a contributor to serious governance issues internationally, particularly when there is a dominant party in that committee.</p> <p>Where all members are not independent, it would be appropriate for there to be a disclosure trigger on this fact.</p>
Potential unforeseen consequences or compliance burdens	<p>2.4(b) may provide an easy way for listed entities to hold themselves to a lower standard than that in 2.4(a) and achieve the same compliance rating.</p> <p>As a matter of principle we believe that</p>

	if not, why not should be applied consistently, and Council should not “coach” listed entities on workarounds.
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### Recommendation 2.5 – Targeted skills and diversity

Escalation to a stand-alone recommendation	Neutral. This could be achieved more elegantly as a component of the proposed recommendation 1.5, if that recommendation is moved to Principle 2.
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### Recommendation 2.6 – Director development

Escalation to a stand-alone recommendation	Agree.
Gaps and deficiencies	We suggest the guidance be expanded to highlight the need for currency and competency on particular areas such as financial literacy, risk management and duties related to sub-committees. Such guidance is consistent with other codes internationally and reminds entities that, while some of these matters may be delegated to subcommittees, all directors have a responsibility to be competent and current in these key areas.

### Principle 3 – Promote ethical and responsible decision-making

Expanded wording to link to long term shareholder value	Disagree. While we agree with the spirit and intent of this change, the possible inference that ethical and responsible decision-making is only required if it is consistent with long-term shareholder value is inappropriate. This may infer that officers have a duty only to act, or a duty not to act, when there may be an impact on share price.
Expanded commentary	Partially agree. While we agree with and support the intent of the expanded commentary in relation to ethical dealing, in effect this principle now deals with only one recommendation related to code of conduct matters. We suggest that either the commentary be rebalanced to more clearly reflect Council’s intention towards a focus on specific aspects of ethical dealing (fraud, corruption, misconduct etc), or a new

	<p>recommendation be added to address the broader issues.</p> <p>This should be considered in conjunction with feedback from stakeholders on proposed recommendation 7.4 on ESG risk.</p> <p>If the commentary is retained, then it should be broadened to include a wider range of issues so as not to give the impression that Council is focused on a narrow set of issues. Some of the emphasis on particular issues looks particularly out of place.</p>
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### Recommendation 3.1 – Code of conduct

Revised wording of recommendation 3.1	<p>Disagree.</p> <p>The 2010 Recommendations contained specific requirements to ensure the code of conduct:</p> <ul style="list-style-type: none"> <li>• Maintained confidence in the entity’s integrity</li> <li>• Addressed legal obligations and reasonable expectations of stakeholders</li> <li>• Allocated responsibility and accountability for reporting and investigating reports of unethical practices.</li> </ul> <p>Under the revised wording a listed entity could comply with the revised recommendation without meeting these requirements.</p> <p>Given that integrity is the current hot topic in governance, such a retrograde step would be inappropriate.</p>
Revised box 3.1	<p>Agree</p> <p>The revised box 3.1 is a clearer, more succinct and more effective summary of the key points in the current version.</p>
Deleted commentary	<p>Disagree</p> <p>IIA-Australia believes that the following commentary in the 2010 release of the Principles and Recommendations is particularly valuable and should be retained.</p> <p><i>Companies should consider making advisers, consultants and contractors aware of the company’s expectations as set out in the code of conduct.</i></p>

#### Principle 4 – Safeguard integrity in financial reporting

Revised wording of principle 4 from structure to process	Partially agree We would prefer to refer to both a structure <b>and</b> a process, or a framework.
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#### Recommendation 4.1 – Safeguard integrity in financial reporting

Consolidation recommendations 4.1 – 4.4.	Agree
Inclusion of recommendation 4.1(b)	Strongly disagree. See potential unforeseen consequences below.
Potential unforeseen consequences or compliance burdens	While we agree with Council’s intention, on reflection 4.1(b) provides an easy way for listed entities to hold themselves to a significantly lower standard than that in 4.1(a) and achieve the same compliance rating.  As a matter of principle we believe that any organisation without an audit committee, should explain what they have in place that addresses the full requirements of 4.1(a) and not a subset of these as set out in 4.1(b).  This may be able to be addressed by broadening the requirements in 4.1(b) beyond “independently verify and safeguard the integrity of its financial reporting” to meeting the full requirements of a contemporary audit committee, however we consider this unlikely to be a practical solution.
Removing the disclosure requirement in the current recommendation 4.4 - information on the procedures for the selection and appointment of the external auditor, and for the rotation of external audit engagement partners.	Disagree We presume this is an unintentional omission, particularly given recent international focus on this issue. We suggest including this in recommendation 4.3.

#### Recommendation 4.2 – Management declaration

Reintroduction of the language of s295A of the Corporations Act to cover listed entities not incorporated in Australia	Agree. This was an unintended consequence of the 2007 revision of the Principles and Recommendations.
Harmonisation of the language in the 2003 release with s295A of the Corporations Act	Agree.

Updating the recommendation to require the declaration to be received before the accounts are signed.	Agree.
Dilution of recommendation 7.3 to remove the requirement that the board should disclose whether it has received assurance from the chief executive officer (or equivalent) and the chief financial officer (or equivalent) that the declaration provided in accordance with section 295A of the Corporations Act is <i>founded on a sound system of risk management and internal control and that the system is operating effectively in all material respects in relation to financial reporting risks.</i>	<p>Disagree.</p> <p>Current recommendation 7.3 was one of the key reforms in the original release of the Corporate Governance Principles and Recommendations, and similar language is present in most exchanges around the world – either by if-not, why-not, listing rule or statute.</p> <p>To Council’s credit, this has driven significant improvements in control and accountability for financial statement integrity and is widely accepted as good practice.</p> <p>Diluting this requirement would be a significant retrograde step and put the ASX out of step with comparable markets.</p>

#### **Recommendation 4.3 – Attendance by the external auditor at the AGM**

New recommendation	Agree.
Gaps and deficiencies	Council may wish to provide suggestions on how security holders may direct questions to the external auditor if they are not able to attend the AGM.

#### **Principle 5 - Make timely and balanced disclosure**

Revised wording	Agree.
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#### **Principle 6 – Respect the rights of security holders**

Revised wording	Agree.
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#### **Recommendation 6.1 – Website**

Elevation of existing guidance to a recommendation	Agree.
Additional guidance and commentary	Agree. Considered useful and informative.

#### **Recommendation 6.2 – Investor relations program**

Revised recommendation	Agree.
Additional guidance and commentary	Agree. Considered useful and informative.

### Recommendation 6.3 – Policies and procedures

Revised recommendation	Agree.
Suggestions	<p>The commentary referring to “meetings outside the main cities” implies that only those within the main cities have a right or interest in participating.</p> <p>We would suggest that it would be appropriate to rephrase this to put the emphasis on providing webcasting or meetings that are appropriate to the locations of the entity’s security holders and allow them to participate.</p> <p>We also suggest with current technology it may be possible for security holders to not only listen to, but engage with meetings through submitting live questions and/or voting.</p>

### Recommendation 6.4 – Policies and procedures

Revised recommendation	Agree.
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### Principle 7 – Recognise and manage risk

Including the term “framework” and the requirement to periodically review the effectiveness of that framework.	Agree
Deleting the term “internal control”.	<p>Disagree.</p> <p>While a sound risk management framework should also generate a sound system of internal control, this is often not the case in practice, and a focus on the internal control framework is still required.</p> <p>This is particularly pronounced for standardised operating areas, which are often better managed by internal control systems than an overarching risk management process.</p>
Potential unforeseen consequences or compliance burdens	Paragraph 8 – implies that institutional investors will have a greater interest in risk management than retail investors. This is not necessarily correct.
Gaps and deficiencies	<p>The two key findings from the numerous reviews internationally into governance were that: companies did not understand the risks that they were taking, and that incentives (explicit and implicit) encouraged excessive risk taking.</p> <p>Outside Australia, the latter element was</p>

	<p>the key area of focus for many regulators and is not expressly dealt with in Principle 7.</p> <p>The proposed recommendation 8.3 addresses a subset of this but stops short of requiring boards to ensure that incentive structures encourage appropriate risk taking that is within the entity's agreed risk appetite. This warrants further exploration.</p> <p>Paragraph 9 highlights that entities not captured by the Corporations Act have lesser obligations for disclosure of risks related to future financial years. If this is the case, then this may warrant a disclosure trigger or a listing rule amendment.</p>
Commentary - Suggested language clarifications	Paragraph 3 - delete the words "material business" and "strategic" as they limit the broader intent and are likely to cause confusion.

### **Recommendation 7.1 – Risk Committee**

New recommendation 7.1(a)	<p>Agree.</p> <p>Given the primary reason for updating the principles and recommendations, this is an appropriate proactive but non-prescriptive response.</p> <p>This approach is consistent with the approach taken by Council to audit committees. Our research internationally indicates that such an approach was more successful than some overly prescriptive approaches and hence is a good precedent for this approach.</p>
New recommendation 7.1(b)	<p>Agree.</p> <p>Having the audit committee undertake these responsibilities should achieve the same effect as implementing 7.1(a).</p>
Deletion of the requirement to disclose a summary of the entity's risk management policies (current recommendation 7.1).	<p>Disagree.</p> <p>We believe that security holders and other key stakeholders will be interested in this information. We suggest re-including this in the new recommendation 7.2.</p>
Suggested wording change	Including the words "and charter" in 7.1(b) to ensure that the full intent of 7.1(a) is achieved.
Potential unforeseen consequences or compliance burdens	As currently drafted, 7.3(c) has a higher disclosure requirement than for those in

	compliance with 7.1(a) or (b).
Gaps and deficiencies	<p>Paragraph 2 of the commentary is not reflective of the roles of contemporary risk committees. IIA-Australia can provide further information on this if required.</p> <p>There is also no mention of the minimum skill requirements of the committee, individually or in aggregate. We draw Council's attention to the work in this area by the DRCO that may assist - <a href="http://www.thegovernancefund.com">www.thegovernancefund.com</a> DCRO/PDF/Qualified_Risk_Director_Guidelines.pdf. This could be addressed in paragraph 4 of the commentary.</p>
Commentary - Suggested language clarifications	<p>Paragraph 6 - delete the word "reporting" as it limits the scope, and focuses on areas now addressed under Principle 4.</p> <p>Paragraph 7 - is inconsistent with the contemporary and distinct roles of a risk function (2<sup>nd</sup> line of defence) and an internal audit function (3<sup>rd</sup> line of defence). The role of internal audit is independent of management. It provides assurance to the audit committee over the effectiveness of the risk management framework and system of internal control. It is not involved in implementation and hence can provide this independent assurance (commonly known as third line of defence).</p> <p>Paragraph 9 - change "internal and external risks" to "internal and external risk sources". This will provide more appropriate risk disclosures while also being consistent with the language of ISO 31000.</p> <p>Paragraph 9 - change "manifests itself" to language more closely aligned to the continuous disclosure rules. This will avoid unintended and potentially unwieldy expectations.</p>

### Recommendation 7.2 – Risk Oversight

Updated recommendation 7.2	<p>Agree.</p> <p>This is an important and appropriate evolution that is consistent with contemporary practice.</p>
Suggested wording change	Delete the words "with management" to allow for independent review, such as with internal audit or an independent

	<p>expert. Alternatively, the review could be an annual review with management, and supplemented by periodic independent review by internal audit or an independent expert.</p> <p>This suggestion is consistent with previous editions of the principles and recommendations and contemporary practice.</p>
Gaps and deficiencies	<p>Commentary paragraph 2 – Suggest an additional sentence to confirm that risk oversight is the ultimate responsibility of the entire board and while some of the work can be delegated to a risk committee, this responsibility cannot be delegated.</p>

### Recommendation 7.3 – Internal audit

Elevation of existing guidance to a recommendation	<p>Strongly agree.</p> <p>See covering letter for supporting statement.</p>
Gaps and deficiencies	<p>Significant gap.</p> <p>The recommendation as proposed is a disclosure recommendation only. There is no requirement for the entity to satisfy themselves on the need for an internal audit function or to ensure that the function is independent or effective.</p> <p>We suggest the that the recommendation state that a listed entity:</p> <ul style="list-style-type: none"> <li>• should have an internal audit function; and</li> <li>• the board or relevant board sub-committee should periodically review the internal audit function to ensure it is: <ul style="list-style-type: none"> <li>○ adequate;</li> <li>○ independent of management; and</li> <li>○ effective.</li> </ul> </li> </ul> <p>These changes would bring the proposed recommendation 7.1(a) in line with comparator exchanges (UK Code, Singapore Code, Hong Kong code, King, NYSE and KLSE requirements).</p>
Wording of 7.3(b).	<p>Disagree.</p> <p>We are concerned that the current wording contained in 7.3(b) confuses two distinct functions (lines of defence).</p>

	<p>The current language suggests a process for improving risk management and internal control. This is a management function and is a subset of the current recommendation 7.1 (commonly known as the second line of defence).</p> <p>The role of internal audit is independent of management. It provides assurance to the audit committee over the effectiveness of the risk management framework and system of internal control. It is not involved in implementation and hence can provide this independent assurance (commonly known as third line of defence).</p> <p>We recommend that if 7.3(b) is to be retained it should ask entities how the board receives <i>assurance</i> over their risk management and internal control systems. The language in the ICGN principles may be useful in this regard - <i>Where the board decides not to establish such a function, full reasons for this should be disclosed in the annual report, as well as an explanation of how adequate assurance has been maintained in its absence.</i></p>
<p>Deletion of commentary of role - <i>the internal audit function will generally carry out the analysis and independent appraisal of the adequacy and effectiveness of the company's risk management and internal control system.</i></p>	<p>Given the above comments, we recommend retaining the 2010 language on this matter.</p> <p>Users may also find it helpful if Council clearly distinguishes between the functions of risk management (2<sup>nd</sup> line of defence) and internal audit (3<sup>rd</sup> line of defence) in the commentary under this section, or in the opening commentary under Principle 7.</p>
<p>Removal of the 2010 supplementary guidance on risk management and internal control from the ASX CGC landing page</p>	<p>Disagree</p> <p>This document was subject to extensive discussion by Council and is a Council approved document. Its intention was to provide supplementary guidance on matters such as those set out above.</p>
<p>Replacement with the small cap guide</p>	<p>Disagree</p> <p>This document has not been approved by Council and has no status.</p>

#### **Recommendation 7.4 – ESG risks**

New recommendation	Agree
Suggested wording change	Paragraph 2 – implies that institutional investors will have a greater interest or need for this information than retail

	investors. This is not necessarily correct.
Potential unforeseen consequences or compliance burdens	<p>It is unclear from this recommendation what Council's intention is.</p> <ul style="list-style-type: none"> <li>• Is it to highlight potential risks that threaten the future share price such as through risks to the viability of the business model or asset values?</li> <li>• Is it to focus entities on the external impact caused by the entity (ie. risks to others)?</li> <li>• Is it a precursor to ESG reporting?</li> </ul> <p>These are all reasonable objectives. We recommend that Council be clear about its intent, and that the language clearly reflect this intent.</p>
Gaps and deficiencies	Without additional clarification, recommendation 7.4 may result in bland statements that do little to encourage better governance or inform investors.

### **Principle 8 – Remunerate fairly and responsibly**

Revised wording	Agree
Gaps and deficiencies	<p>The two key findings from the numerous reviews internationally into governance were that: companies did not understand the risks that they were taking, and that incentives (explicit and implicit) encouraged excessive risk taking.</p> <p>Outside Australia, the latter element was they key area of focus for many regulators.</p> <p>The proposed recommendation 8.3 addresses a subset of this but stops short of requiring boards to ensure that incentive structures encourage appropriate risk taking in the first instance that is within the entity's agreed risk appetite. Given the lessons of the GFC, this warrants further exploration.</p> <p>We were also surprised that there is not a requirement for security holder approval before entering into an equity-based incentive plan. This has been a contentious issue in the past and is likely to be so again.</p>

### **Recommendation 8.1 – Remuneration committee**

Consolidation of existing	Agree
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recommendations	
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**Recommendation 8.2 - Remuneration policies**

Remuneration guidelines (table)	Where these elements could also impair director independence, they should be listed in Box 2.1.
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**Recommendation 8.3 - Clawbacks**

New recommendation	Agreed.
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**Recommendation 8.4 – Equity based remuneration**

New recommendation to capture previous disclosure trigger	Agreed.
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