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

The Institute of Directors (IoD) appreciates the opportunity to comment on the ASX Corporate Governance Council's consultation draft updating its Corporate Governance Principles and Recommendations (the Principles and Recommendations) last updated in 2014. We welcome the review and the updating of the Principles and Recommendations to ensure that they are current, effective for good corporate governance reporting, and aligned with best practice.

About the Institute of Directors

The IoD is a non-partisan voluntary membership organisation committed to driving excellence in governance. We represent a diverse membership of over 8,700 members drawn from listed issuers, large private organisations, small and medium enterprises, state sector organisations, not-for-profits and charities. Many of our members serve on boards of issuers listed on the ASX and other organisations operating in Australia.

The IoD's *Code of Practice for Directors* provides guidance to directors to assist them in carrying out their duties and responsibilities with high professional standards. All IoD members sign up to the Code.

Our Chartered Membership pathway aims to raise the bar for director professionalism in New Zealand, including through continuing professional development to support good corporate governance.

Overview of the Principles and Recommendations and the proposed changes

The Principles and Recommendations apply to entities listed on the ASX (which includes some New Zealand entities) and follow a tier approached to reporting (ie there are Principles, Recommendations and Commentary). Entities must disclose in their annual reports whether they comply with the Recommendations and if not, why not. This is a similar format to the NZX Corporate Governance Code which was significantly revised in 2017.

The overall structure of the Principles and Recommendations in the consultation draft is largely the same as the current version. However there are amendments to the Principles, nine new Recommendations, and significant revisions to the Commentary. These proposed changes are aimed at addressing recent and emerging corporate governance issues eg around corporate values and culture, social licence to operate, whistleblowing, anti-bribery and corruption, diversity, carbon risk, and cybersecurity.

The Council has indicated that the final version of the updated Principles and Recommendations will be released in early 2019 and will take effect for an entity's first full financial year commencing on or after 1 July 2019.

General Comments

A lot has changed in the corporate governance landscape since 2014 and it is timely that the Principles and Recommendations are updated to ensure they are modern and fit for purpose. We generally support the Council's approach to the consultation draft and the proposed areas of reform.

We welcome proposed changes in the consultation draft which are consistent with the NZX Corporate Governance Code. Consistency in corporate reporting is important to the market, issuers operating in both Australia and New Zealand, and stakeholders and shareholders. We note that some of the proposed changes go beyond those in the NZX Corporate Governance Code in terms of raising standards and New Zealand entities not subject to the Principles and Recommendations may adopt them on a voluntary basis as part of good corporate governance.

There is a significant increase in the number of *Recommendations* in the Principles and Recommendations (from 29 to 38). Having a large number of Recommendations may reduce the effectiveness of the Principles and Recommendations and create a culture of *tick-box compliance*. The increasingly prescriptive governance environment is of growing concern for issuers and boards, and we suggest the Council consider this in finalising the Principles and Recommendations.

Specific comments

We set out below our comments on some of the proposed changes.

Culture

Principle 3 has been substantially redrafted from "a listed entity should act ethically and responsibly" to "a listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically, and in a socially responsible manner". There are also new Recommendations for listed entities to articulate and disclose their core values, to have and disclose whistleblowing and anti-bribery and corruption policies, and ensure that the board is kept informed of any concerns and breaches in relation to those policies. The Commentary now acknowledges that a listed entity's social licence to operate is one of its most valuable assets and it can be impacted if personnel act unlawfully, unethically or in a socially irresponsible manner.

It is the role of the board and senior managers to lead culture in organisations and to 'set the tone'. Boards must also ensure that governance structures, control mechanisms and organisational culture support good conduct. As part of comprehensive risk management, it is crucial that boards assess conduct risk within their organisation and hold management to account, including through comprehensive and regular reports and follow through. In the light of recent corporate governance failures and incidents in Australia and globally we believe the proposed changes are necessary, and should lead to increased discussions and focus on culture and conduct.

Gender diversity

The consultation draft includes substantial changes aimed at achieving better gender diversity outcomes. A key change is the Recommendation (1.5) that if an entity is in the S&P/ASX 300 index then the measurable objective for gender diversity on the board should be not less than 30% of each gender. We note that in 2015 the Australian Institute of Corporate Directors (AICD) set a target of 30% women on the boards of ASX 200 companies by 2018.

The IoD has long held that the ultimate goal of board diversity is diversity of thought and capability. Board diversity brings a broader range of perspectives to the boardroom and increases the potential for success, effective risk oversight and long-term business sustainability.

In 2016, the IoD published a guide, *Getting on board with diversity*, and wrote to all NZX chairs encouraging them to set a target of 30 to 50 percent woman on their boards. Board gender targets are increasingly common in developed countries around the world and in our view are preferable to mandatory quotas. The proposed Recommendation should help drive greater change than is currently occurring in Australia and this may have a flow on effect in New Zealand.

Board skills matrix
Proposed changes to the Commentary on Recommendation 2.2 (that a board should have a board skills matrix) set out what should be included in a board skills matrix and note the increasing need to address new issues such as digital disruption, cybersecurity, culture, sustainability and climate change. Using a board skills matrix can help ensure that boards have an appropriate mix of skills and experience, and the inclusion of the above issues reflects the needs of a modern board. Board skills matrices are increasingly used and disclosed and the Commentary should be helpful for issuers and stakeholders.

Sustainability disclosures
Recommendation 7.4 states: “A listed entity should disclose whether it has any material exposure to environmental or social risks and, if it does, how it manages or intends to manage those risks”. A proposed change to the Commentary suggests that entities with a *material exposure* to climate change risk should consider implementing the recommendations of the Financial Stability Board’s Task Force on Climate-related Financial Disclosures (TCFD recommendations).

There is a global trend for more holistic corporate reporting that may include climate change risks, however the particular frameworks and metrics are still evolving. Many organisations have already adopted established frameworks such as the Global Reporting Initiative or Integrated Reporting. It is important that boards continue to have the ability to decide to what extent reporting may be useful and what reporting frameworks would be most appropriate for their organisation. However, we recognise that TCFD recommendations are expected to be increasingly influential, and that is appropriate that they are referred to in the Commentary. We also encourage issuers to take the lead in relation to climate change reporting, rather than potentially being subject to a mandatory reporting regime.

Validate reports
The addition of a new Recommendation (4.4) requires a listed entity to disclose its process to validate its annual report and any other corporate reports it publishes. The Commentary clarifies that “where an entity’s annual directors’ report, integrated report, quarterly activity report… or other corporate report is not subject to assurance by the entity’s external auditor, the entity should have an appropriate process in place to validate that the report is accurate, balanced and understandable…”

We agree with the value and importance in having an entity’s reports validated, however we note that there are currently no agreed auditing frameworks in place for some reporting frameworks, such as Integrated Reporting. Given this, complying with this recommendation may prove difficult for entities.

We appreciate the opportunity to comment on behalf of our members.

Yours sincerely

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