

19 July 2018

Ms Elizabeth Johnstone  
Chairman  
ASX Corporate Governance Council  
20 Bridge Street  
SYDNEY, NSW 2000

Email: [Kevin.Lewis@asx.com.au](mailto:Kevin.Lewis@asx.com.au)

Dear Ms Johnstone,

**RE: SUBMISSION ON THE PROPOSED FOURTH EDITION OF THE CORPORATE GOVERNANCE COUNCIL PRINCIPLES AND RECOMMENDATIONS**

The Institute of Internal Auditors – Australia (IIA-Australia), as a member of the ASX Corporate Governance Council (ASX CGC), is pleased to make this submission to the Council with respect to the 4<sup>th</sup> Edition Consultation Draft of its Principles and Recommendations.

**Introduction**

Despite best endeavors by regulators and directors, value destruction and reputational scandals continue to occur in the financial services sector.

At the internal auditor’s conference held in Melbourne in May 2018, ASX Corporate Governance Council Chair Ms Elizabeth Johnstone threw out a rallying cry to internal auditors “not to be timid, but be bold and brave.”

The challenge for an internal auditor is to remain independent, objective, and be tough enough to deliver the bad news as well as the good.

But in complex corporate environments where there are numerous layers of senior management and committees, it is easy to see how these reports can be de-railed.

The recent revelations from the Banking and Financial Services Royal Commission and Australian Prudential Regulation Authority’s (APRA) Prudential Inquiry into CBA highlighted issues raised by internal auditors, and found that many reports were either ignored in part, or not acted upon by layers of management.

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The ASX Corporate Governance Council has an important opportunity to address these issues in their revised Principles and Recommendations.

To be bold and brave, as Ms Johnstone suggests, means that reporting lines have to change, and internal auditors have to be given more authority by boards to apply their skills across the organisation.

These policy reforms should be considered in the revised Fourth Edition of the Consultation draft.

### **Submission**

IIA-Australia welcomes the opportunity to comment on this consultation draft.

Specifically, IIA-Australia welcomes the recommendation that corporate governance statements become an opportunity for boards of listed entities to demonstrate that they are alive to the importance of having proper and effective corporate governance arrangements, and to communicate the robustness of their particular approach to corporate governance.

IIA-Australia believes more transparency in the governance structure and processes improves outcomes for listed entities. In that regard, “ ... boards should establish formal and transparent policies and procedures to ensure the independence and effectiveness of internal and external audit functions.”<sup>1</sup>

### **Principle 1 – Recommendation 1.1**

Using The Institute of Directors – South Africa King IV Report (Principle 15) as input – The board is also responsible for ensuring that assurance services and functions enable an effective control environment, and that these support the integrity of information for internal decision-making, and of the organisation’s external reports.

IIA-Australia recommends inclusion under Commentary of the following bullet point.

Usually the board of a listed entity will be responsible under its charter for:

- ensuring that the reporting line of the internal audit function promotes objective, independent and relevant assurance that contributes to the effectiveness of governance, risk management and control processes.

### **Comment on Principle 3**

The ASX CGC should consider Principle 2 of the King IV report, which states “The Board should govern the ethics of the organisation in a way that supports the establishment of an ethical culture.”<sup>2</sup>

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<sup>1</sup> Financial Reporting Council – Proposed Revisions to the UK Corporate Governance Code, Appendix A, p. 9.

<sup>2</sup> Institute of Directors South Africa, King IV Report on Corporate Governance, 2016, p. 44

IIA-Australia also supports the spirit of Principle 3, in particular 3.1 “A listed entity should articulate and disclose its core values”. As the UK Corporate Governance Code states “ ... in order to establish an appropriate culture, a board must define the purpose, strategy, and the values of the company, and consider the type of behaviours it wishes to promote in order to deliver its business strategy. Boards should seek assurance about the health of the culture by taking the temperature of the organization on a regular basis.”<sup>3</sup>

In that regard, IIA-Australia recommends that listed entities periodically conduct audits of culture to measure the core values set by the board and carried out by senior management.

### **Recommendation 3.1**

IIA-Australia would like to see cited in a footnote the publication *Managing Culture: A good practice guide* (2017), produced by The Institute of Internal Auditors – Australia, The Governance Institute of Australia, Chartered Accountants ANZ and the Ethics Centre. The first three organisations are all members of the ASX Corporate Governance Council. The publication was co-launched by Ms Elizabeth Johnstone in December 2017.

### **Comment on Principle 4**

States among other things that the role of the audit committee is to review and make recommendations to the board in relation to:

- if the entity has an internal audit function:
  - the appointment or removal of the head of internal audit;
  - the scope and adequacy of the internal audit work plan; and
  - the objectivity and performance of the internal audit function.

IIA-Australia strongly supports this position.

It goes on to say that the audit committee should have a charter that clearly sets out its role and confers on it all necessary powers to perform that role.

We believe it would be helpful to include a footnote that references the publication *Audit Committees: A Guide to Good Practice*, Third Edition (2017) which contains an example of an audit committee charter, and other useful information to assist members of audit committees. This publication was jointly authored by the Australian Institute of Company Directors, the Auditing and Assurance Standards Board, and IIA-Australia.

### **Recommendation 6.3**

In the second paragraph it is recommended that the words “the majority of” follow the word “to” in the sentence. The revised sentence would read: “A listed entity should choose a venue for a meeting of security holders that is reasonably accessible to the majority of security holders who wish to attend the meeting in person or by proxy.”

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<sup>3</sup> UK Corporate Governance Code, Proposed Revisions Appendix B, pp. 7-8

This suggested change follows the well-publicized example in 2017 of an AGM being conducted in Singapore making it difficult for the majority of members who were domiciled in Australia from attending the AGM.

### **Principle 7 – Recommendation 7.3**

The internal audit function also plays an important role in reporting to the board, through the audit committee, on the state of governance within and across organisations. It is the only function capable of objectively reporting on the effectiveness of governance systems and on culture.

For this reason, in the wording of Recommendation 7.3 (b), the word “governance,” should be inserted before the words “risk management”. This part of the recommendation would then read “(b) if it does not have an internal audit function, that fact and the processes it employs for evaluating and continually improving the effectiveness of its governance, risk management and internal control processes.”

This change in wording should also be reflected in the first paragraph of the Commentary.

There is no required standard governing the practice of internal audit in Australia. This leaves open the quality of work performed by internal audit practitioners. It also leaves directors, who have a duty of care to perform for their organisations, vulnerable to shoddy and unqualified work practices.

Footnote 66 needs to be reworded. The International Standards for the Professional Practice of Internal Auditing do not provide guidance for determining how best to structure and staff the internal audit function. The *Standards* are a set of principles-based, mandatory requirements that all internal auditors should follow. They specify *Standards* relating to individual objectivity, proficiency, due professional care, and the *Standards* relevant to the performance of their job responsibilities.

Heads of internal audit are additionally accountable for the internal audit’s overall conformance with the *Standards*.

For these reasons, the wording of Footnote 66 should state: “Listed entities that have or wish to have an internal audit function should ensure that function fully conforms to the International Standards for the Professional Practice of Internal Auditing published by the International Internal Audit Standards Board.”

The wording in the second paragraph of the Commentary relating to the “ ... head of the function should be suitably qualified ... ” requires minor rewording.

In practice, many executives are appointed to head the internal audit function without being qualified. This practice provides those executives with a unique and broad understanding of the organisation and how it functions, and is often a stepping-stone to more senior roles within a company.

To acknowledge this state of affairs, the phrasing in the second paragraph should be reworded to read “ ... head of the internal audit function be suitably qualified themselves or have access to someone who is ...”

We also believe a footnote is necessary at the end of this sentence that describes what “suitably qualified” looks like. This footnote should read “Suitably qualified means someone who is a Certified Internal Auditor, or possesses a higher education Graduate Certificate in Internal Audit qualification, or is deemed qualified by a panel of peers through the Institute of Internal Auditors – Australia.”

*Original signed*

Peter M. Jones  
Chief Executive Officer

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Level 7, 133 Castlereagh Street, Sydney NSW 2000 | PO Box A2311, Sydney South NSW 1235  
T +61 2 9267 9155 F +61 2 9264 9240 E [enquiry@iia.org.au](mailto:enquiry@iia.org.au) [www.iia.org.au](http://www.iia.org.au)

ABN 80 001 797 557

## About the Institute

The Institute of Internal Auditors (The IIA) is the global professional association for internal audit practitioners, with global headquarters in the USA, and with Institutes throughout the world including Australia (IIA-Australia). The IIA was established in 1941, and now has more than 196,000 members from 190 countries throughout the world, including 3,000 members in Australia.

As the chief advocate of the internal audit profession, The IIA serves as the profession's international standard-setter, sole provider of globally accepted internal auditing certifications, and principal researcher and educator.

The IIA sets the bar for internal audit integrity and professionalism around the world with its International Professional Practices Framework (IPPF®), a collection of guidance that includes the International Standards for the Professional Practice of Internal Auditing, and the Code of Ethics for internal auditors.

The Code of Ethics states the principles and expectations governing behavior of individuals and organisations in the conduct of internal auditing. It describes the minimum requirements for conduct and behavioral expectations, rather than specific activities.

The International Standards for the Professional Practice of Internal Auditing issued by the International Internal Audit Standards Board of The IIA are the *Standards* governing internal auditing worldwide.

Our members work in internal auditing, risk management, governance, internal control, information technology audit, education, and security.

There are no legislated Standards applicable to internal auditing in Australia, therefore the ASX Corporate Governance Council Principles including the International Standards for the Professional Practice of Internal Auditing play a vital role in promoting good governance.

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