

ASX Corporate Governance Council

Attention: Mavis Tan

Via email: mavis.tan@asx.com.au

28 June 2018

I am pleased to provide the ASX Corporate Governance Council (ASXCGC) with my views on its draft 4th edition of the Corporate Governance Principles and Recommendations. This submission reflects my position as a consultant to listed and unlisted business including Not-for-Profits (NFPs), and their own advisers including auditors who have an interest in corporate governance. This submission has also benefited from discussions with a number of key constituents.

The proposals in the draft fourth edition have my general support subject to the specific issues that are dealt with in this submission (Appendix A Points the ASXCGC requested comment on, and Appendix B Other Issues for the ASXCGC to consider).

Please contact me if you wish to discuss any of the issues that are raised in this submission.

Kind regards

A handwritten signature in black ink, appearing to read 'Keith Reilly', with a stylized flourish at the end.

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Appendix A

Points the ASX Corporate Governance Council (ASXCGC) requested comment on

whether stakeholders agree with the nine proposed new recommendations and, if not, why not;

Comment: Yes. Subject to my further comments on other Issues which the ASXCGC requested comments on, the nine proposed new recommendations are broadly supported.

whether stakeholders agree with the changes proposed to the existing recommendations in the third edition and, if not, why not;

Comment: Yes. Subject to my further comments on other Issues which the ASXCGC requested comments on, the nine proposed new recommendations are broadly supported.

specifically, whether stakeholders agree with the Council'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;

Comment: Yes, for the disclosure of measurable objectives.

Comment: No for the disclosure of measurable objective of 30%.

I am of the view that society believes that gender equality should reflect the gender statistics of the Australian population, and on that basis, there should be an increase in the measurable objectives to 40%, and further disclosure to 50% given that according to the Australian Human Rights Commission females make up just over half (50.7%) of the Australian population. It is not much of a stretch for an increase from 26.2% that currently exists to 30%. Further details on gender equality in the workforce are detailed at:

<https://www.humanrights.gov.au/education/face-facts/face-facts-gender-equality-2018#fn20>

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

Comment: Yes.

whether stakeholders agree with Council's proposed changes to box 2.3, setting out the factors relevant to assessing director independence;

Comment: Yes, for the proposed changes.

Comment: No for allowing the Board to determine whether a director can be categorised as independent after being on the Board for more than 9 years. They are not independent as that cannot be 'seen' to be independent. In a submission I authored for Macquarie University on the draft 3rd edition of the Principles and Recommendations it was stated:

We question whether a director who has been on the Board for more than 9 years can be 'perceived to be independent' after that length of time. We note that Independence is defined in the global accounting bodies' standards as being both 'seen to be and actually' independent, so this criticism is not based on an individual's attributes but on a market perspective. We note that the Council has stated that it will monitor developments in this area, however given debates on audit firm independence in the EU and the UK, we suggest that the tide has turned, and the public interest view is that a sufficiently long time (9 years), does provide more than an indication of a question as to independence.

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;

Recommendation 3.2:

A listed entity should:

(b) ensure that the board is informed of:

(1) any material breaches of that code by a director or senior executive; and

(2) any other material breaches of that code that call into question the culture of the organisation.

Comment: No. Whilst illegal acts are mentioned in the Commentary, the Recommendation should specifically require the Board to state that it has made enquiries of management and is not aware of any illegal activity. The evidence given so far in 2018 to the Financial Services Royal Commission is clear evidence of Boards that should have been informed (i.e. money laundering) and were or where seem to not be informed.

Macquarie University's submission on the draft 3rd edition of the Principles and Recommendations stated:

Inclusion of a Specific Recommendation on Bribes

Given the current media debate on alleged illegal practices of some Australian organisations in paying bribes or facilitation fees to overseas government officers (e.g. Chanticleer 3 October 2013 – Transparency never a strong suit: "The practice of paying kickbacks is rife within Asia, the Middle-East, East Africa and other parts of the world where Australian companies do business."), consideration should be given to making Boards accountable for ensuring that the risk management process inhibits companies from engaging in unacceptable if not also illegal practices. We suggest making an 'if not, why not' requirement for a clear statement of compliance on 'facilitation fees' as otherwise even more prescriptive legislation may be needed. We note that the International Corporate Governance Network's (ICGN) Corporate Governance Principles (2009) state (section 3.4) that its expectation is that there should be stringent policies and procedures in place to avoid company involvement in such behaviour.

Recommendation 3.3

A listed entity should:

(a) have and disclose a whistle-blower policy that encourages employees to come forward with concerns that the entity is not acting lawfully, ethically or in a socially responsible manner and provides suitable protections if they do; and

(b) ensure that the board is informed of any material concerns raised under that policy that call into question the culture of the organisation.

Comment: Yes. This was a suggestion from the 2013 Macquarie University Submission.

Recommendation 3.4

A listed entity should:

- (a) have and disclose an anti-bribery and corruption policy; and
- (b) ensure that the board is informed of any material breaches of that policy.

Comment: Yes. This was a suggestion from the 2013 Macquarie University Submission.

Inclusion of a Specific Recommendation on an effective whistle-blowing system

We further note that the ICGN (section 3.7) recommends that companies have a whistle-blowing mechanism in place and the board needs to be satisfied that any concerns are handled effectively. We suggest that this would be a further way of inhibiting corrupt behaviour, using an 'if not, why not' disclosure mechanism.

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;

Comment: No. I am not aware of any unforeseen consequences or undue compliance burdens

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; and

Comment: Yes, but subject to issues raised in this Submission, the guidance seems appropriate.

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.

Comment: Yes. I believe that there are some gaps or deficiencies as detailed in this submission.

Other Issues

Comparison with other Global Codes of Conduct

Comment: The 2013 draft of the 3rd edition of the Principles and Recommendations had several references to other countries' developments on corporate governance. As detailed in the 2013 Macquarie University Submission, benchmarking against countries' Codes ensures that Australia has a Code that is world's best practice, and I encourage the ASXCGC to engage in such an exercise and disclose publicly. In particular the 2013 Submission stated:

As detailed elsewhere in this submission, we see benefit in having consistent global requirements and we encourage the Council to engage with other local and international bodies in working towards a global Code that aligns with global Accounting, Auditing and Ethical Standards.

We acknowledge that there are philosophical differences between some of the requirements. However, the essential and common requirement is for companies to demonstrate how they are able to meet accepted corporate governance practices, and therefore, it is conducive to have a common framework of global corporate governance practices, rather than requiring each jurisdiction to continually update for new and emerging innovations in corporate governance, which this current review does by reference to various other Corporate Governance Codes.

Differing legislative requirements and cultures should not be a barrier to having common global requirements. If there are reasons for national differences in how requirements are implemented, then it is good corporate governance for those nations to publicly justify any such differences.

In my opinion the ASXCGC can show leadership by exploring with other countries how to develop a global Corporate Governance Code.

Need for a short Annual Review

Comment: As detailed in the 2013 Macquarie University Submission, I see merit in a continuous review and if need be update to the Principles and Recommendations.

Annual Comments invited

In terms of timing or considering changes to the ASX CG Principles, we note that this will be the fourth time that the Principles have been reviewed (first introduced in 2003 and revised in 2007 and 2010).

We suggest that it would be useful for the Council to annually issue for public comment an Update on changes in global Corporate Governance thinking and that this would ensure that Australia's Corporate Governance requirements reflect world's best practice. Our view is influenced by the reality that financial reporting (accounting standards), auditing and ethical requirements are all based on international requirements, and we suggest that this should be no different to corporate governance requirements.

Page 7: Recommendations that are not applicable

In such a case, the Council has no issue with an entity stating that it follows all the Council's recommendations provided, of course, it does in fact follow all the Council's recommendations apart from those that technically do not apply to it, and it meets the disclosure standards set out above for all the recommendations that it does follow.

Comment: From a completeness perspective, it is suggested that the particular Recommendation be disclosed as there may be some debate as to whether a company has properly interpreted the Recommendation, given that there are no audit requirements on the Corporate Governance Statement

Box 1.5: Suggestions for the content of a diversity policy

2. Express the organisation's commitment to diversity at all levels and in all its facets, including gender, marital or family status, sexual orientation, gender identity, age, physical abilities, ethnicity, religious beliefs, cultural background, socio-economic background, perspective and experience.

Comment: Recommendation 1.5 should specifically require the Diversity Policy to state the requirements of Box 1.5, rather than just being part of the Commentary. Whilst the specific recommendations contain further detail on gender diversity, diversity should not be limited to just gender.

Recommendation 4.4:

A listed entity should have and disclose its process to validate that its annual directors' report and any other corporate reports it releases to the market are accurate, balanced and understandable and provide investors with appropriate information to make informed investment decisions.

Commentary

To understand a listed entity's performance and prospects, in addition to the historical financial information included in its annual financial report, the market needs the current and forward-looking information usually included in the annual directors' report.

For listed entities established in Australia, the operating and financial review included in the annual directors' report must contain information that security holders reasonably require to make an informed assessment of the entity's operations, financial position, business strategies and prospects for future financial years.

Some entities use the principles of "integrated reporting" as a useful framework for preparing operating and financial reviews to provide the market with information about a listed entity's future prospects, risks and opportunities, strategy and business model. Some are required under the Listing Rules to prepare quarterly activity reports and quarterly cash flow reports that are not typically subject to audit or review by the entity's external auditor. Some also release to the market other corporate reports, such as a "sustainability report", to provide insights into other aspects of their operations.

Where an entity's annual directors' report, integrated report, quarterly activity report, quarterly cash flow 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 and provides the market with appropriate information to make informed investment decisions.

These processes should be disclosed to assist the market in assessing the quality of the information included in these corporate reports.

Comment: The Commentary implies that Integrated Reporting should be a disclosable time, so why not just make it a Recommendation for at least the S&P/ASX 300.

The 2013 Macquarie University Submission stated:

We concur at this time that Integrated Reporting is still too new (Framework being released by the end of 2013) despite its success in South Africa.

However, 5 years later, Integrated Reporting has been well supported by major entities globally, and now is the time to make it a Recommendation for the S&P/ASX 300.

Recommendation 7.4:

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.

Commentary

As mentioned above in the commentary to principle 3, a listed entity's "social licence to operate" is one of its most valuable assets. That licence can be lost or seriously damaged if the entity conducts its business in a way that is not environmentally or socially responsible.

Investors recognise this and increasingly are calling for greater transparency on the environmental and social risks faced by listed entities, so that they in turn can properly assess the risk of investing in those entities.

To make the disclosures called for under this recommendation does not require a listed entity to publish an "integrated report" or "sustainability report". However, an entity that does publish an integrated report in accordance with the International Integrated Reporting Council's International <IR> Framework, or a sustainability report in accordance with a recognised international standard, may meet this recommendation simply by cross-referring to that report.

Entities that believe they do not have any material exposure to environmental or social risks should consider carefully their basis for that belief and benchmark their disclosures in this regard against those made by their peers.

One particular source of environmental risk relates to climate change. This is also referred to generically as "carbon risk" and includes:

- physical risks, such as the risk of assets being destroyed or rendered unproductive, or business operations being disrupted, by extreme weather events or long-term shifts in climate patterns;
- transition risks, such as the risks arising from changes in legislation or government policy, or the need to adopt new technologies, seeking to mitigate the effects of climate change or facilitating the shift to a lower carbon economy; and
- liability risks, where people who suffer damage caused by climate change, or a failure to respond to climate change, seek redress from those they believe are responsible.

Many listed entities will be exposed to these types of risks, even where they are not directly involved in mining or consuming fossil fuels.

The Council would encourage entities that have a material exposure to climate change risk to consider implementing the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD).

Comment: The TCFD disclosures by the S&P/ASX 300 should be a Recommendation, and not just Commentary.

Recommendation 4.1:

The board of a listed entity should:

(b) if it does not have an audit committee, disclose that fact and the processes it employs that independently verify and safeguard the integrity of its corporate reporting, including the processes for the appointment and removal of the external auditor and the rotation of the audit engagement partner.

Commentary

any proposal for the external auditor to provide non-audit services and whether it might compromise the independence of the external auditor;

Comment: EU audit reforms are now applicable and whilst this is more of a legislative decision, the Recommendations should require disclosure of the length of the audit firm's tenure, and if longer than 10 years what steps the entity has taken to ensure auditor independence. In particular the EU requirements are:

Mandatory audit firm rotation is introduced (Regulation, Articles 16 and 17, hardwired into UK law in [the Statutory Audit and third Country Auditors Regulations part 3](#) (amending the Companies Act 2006, s490 et seq)), such that PEs have to appoint a new firm of auditors every 10 years. The UK has taken up a member state option to extend this maximum period to 20 years provided the audit is subject to a public tendering carried out at least every 10 years.

<https://www.pwc.com/gx/en/services/audit-assurance/publications/eu-audit-reform-legislation.html>