CORPORATE GOVERNANCE
FOCUS ON RISK AND COMMUNICATION

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Communicating with investors is a key theme in the proposed changes to corporate governance reporting as contained in the draft third edition of the *ASX Corporate Governance Principles and Recommendations* released by the ASX Corporate Governance Council on 16 August 2013.

In this Insight we review the proposed changes which, if approved, will come into effect from 1 July 2014. They will be replicated in a number of governance-related amendments to both the ASX Listing Rules and Guidance Note 9 *Disclosure of Corporate Governance Practices.*

The proposed changes to the ASX Corporate Governance Principles and Recommendations have been primarily driven by lessons learned in the post GFC environment and a concern to strengthen the **Recommendations relating to risk**. In addition, the ASX Corporate Governance Council has recognised the investment risks posed for companies associated with the increasing attention being paid to **social and environmental issues**.

Issues of **diversity** have been further clarified as well as dealing with a couple of governance matters raised by Government, including the **clawback of remuneration** and employment of people with disability. Greater flexibility is provided in relation to how corporate governance statements can be disclosed, including via the entity's **website**, and the new edition also seeks to address the position of **foreign entities** not subject to the Corporations Act.

Proposed corporate governance changes

The following summarises the new recommendations (highlighted in red) and where previous commentary will be elevated to specific Recommendations.

- **Focus on Risk:** Risk management permeates through a number of the proposals contained within this draft. Recommendations 7.1 to 7.3 outline the alternate approaches entities can adopt in relation to **risk committees** (or otherwise disclosing the processes for overseeing risk); the requirement to review the risk management framework annually (at minimum); and disclosing whether such a review has taken place. The proposed Recommendations advocate disclosing details of **internal audit functions** (or otherwise the processes companies employ for evaluating risk management and internal control processes).
- **Sustainability Risk Reporting:** ASX has elected not to follow the overseas practice of requiring the production of a Sustainability Report but has instead introduced a **new proposed Recommendation (7.4)**. This will require an entity to disclose whether it has regard to economic, environmental and social sustainability risks in conducting its business and, if so, how it manages those risks.

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- **Flexibility for Smaller Entities:** A number of proposed Recommendations allow for listed entities to adopt and report alternative practices, recognising that many (but particularly smaller companies) may legitimately have different governance practices. These include alternative reporting options where entities decide not to have nomination, audit, risk or remuneration committees or internal audit functions. This will enable a larger number of entities to report positively that they have complied with recommendations.
- **Reporting on Diversity:** Under this proposal companies can choose to report their "Gender Equality Indicators" under the *Workplace Gender Equality Act, 2012* instead of reporting the respective proportions of men and women on the board, in senior executive positions and across the whole organisation. In relation to recommending that companies be required to report the number of people that they employ with a disability, the Council was of the view that this could not be characterised as a matter of corporate governance and chose not to include it as a recommendation.
- **Remuneration Clawback Policy:** This is one of the **new proposed Recommendations** which will require entities to put in place a policy for the clawback of performance-based remuneration from senior executives in certain circumstances. The proposed Recommendation also includes disclosure of the policy and any clawbacks made (or which should have been made) during the reporting period.
- **Website disclosure:** provides companies with greater flexibility to make their **corporate governance disclosures on their website** rather than their annual report. If the corporate governance statement is disclosed on the entity's website, a copy of it will also have to be lodged with ASX at the time of lodging the annual report.
- **Foreign Incorporated Entities and Financial Reporting**: A number of proposed amendments will, if adopted, result in certain Recommendations (including those regarding a declaration from the CEO and CFO with respect to the integrity of an entity's financial records and financial position and the attendance of an entity's auditor at its AGM) applying equally to foreign incorporated and Australian incorporated entities.

Board related recommendations

The proposed Recommendations formalised that listed entities should:

- **undertake appropriate background checks** on proposed directors before their appointment, or putting them forward for election by security holders;
- **provide security holders with all material information** relevant to a decision on whether or not to elect or re-elect a director; and
- have a written agreement with each director and senior executive setting out the terms of their appointment.

In addition, it is specifically recommended that:

- the company secretary should have a direct reporting line to the chair of the board;
- the board of a listed entity should have a nomination committee which (1) has at least three members, a majority of whom are independent directors; and (2) is chaired by an independent director;
- a listed entity should have a program for inducting new directors and providing appropriate professional development opportunities for continuing directors to develop and maintain the skills and knowledge needed to perform their role as a director effectively; it should also disclose a summary of the main features of the program;
- the criteria for a director to be considered independent be expanded to cover relationships in the prior 3 years that include close family ties and a material supplier or customer of the entity or related entities. In addition that service on the board for 9 years may also be considered as a possible indicator that a director may no longer be independent.

If the proposals are adopted, they will take effect from **1 July 2014** and listed entities will need to:

1. review their current corporate governance policies and practices carefully and ensure that they are updated and modified as appropriate in light of any new requirements;
2. make arrangements for appropriate disclosure of corporate governance information on the entity's website; and
3. take steps to ensure that their investor relations program and approach to communicating with the market generally can be both demonstrated and clearly articulated.

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