ASX CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS, 4TH EDITION

Guidance for Boards
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The 4th Edition in its final form is undoubtedly cleaner and more succinct than the Consultation Draft and removes uncertainties which were inherent in that Draft, such as those arising from the "social licence to operate" and Recommendations which potentially conflicted with the conventional understanding of the duties and responsibilities of directors in Australia.

Emerging from it are four Key Messages which will require careful deliberation by Boards:

- the responsibilities of the Board (Principle 1);
- culture and values (Principle 3);
- identification and management of risk (Principle 7); and
- remuneration (Principle 8).

And not just careful consideration; they will most likely require listed entities to redraft their Board Charters and the charters of its committees together with their stated corporate governance procedures. In this Guidance we analyse the 4th Edition's impact, and the issues to be addressed by Boards and Management when implementing the 4th Edition.

The 4th Edition is not however the only part of the corporate governance puzzle for corporate Australia. The revised Principles should be read in conjunction with the Report Commissioned by APRA in relation to the Commonwealth Bank of Australia and the Final Report of the Financial Services Royal Commission. While we recognise that the APRA Review and the Royal Commission dealt with entities providing financial services, it is clear that the lessons learnt will be applied more broadly.

The 4th Edition is not perfect; we have identified some missed opportunities and areas for future clarification and discussion that will no doubt form part of the ongoing conversation on corporate governance in Australia. However, overall the ASX Corporate Governance Council is to be commended for the 4th Edition as published, and in particular Principles 1, 3 and 7.

In conclusion, it must be remembered that the ASX Corporate Governance Principles and Recommendations were first published in 2003 as voluntary Recommendations which apply to ASX-listed entities on an "if not, why not" basis, so as to forestall the sort of highly prescriptive legislation on corporate governance that was introduced around that time in the United States. In our view it remains to be seen whether the 4th Edition alone will be adequate to meet the ever increasing community expectations of corporates, given some of the challenges that will be faced by entities in implementing them in practice. This is particularly so with the spotlight and pressure on entities to implement non-financial metrics for long-term executive remuneration incentives. APRA Chairman Wayne Byres, in his address at the AFR Banking and Wealth Summit, stated that in his view, "attempts to move away from the conventional model of executive remuneration have not been wholly welcomed and so it seems inevitable that regulatory intervention and a greater degree of prescription will be required to shift practices". Overall the regulatory direction we appear to be heading may become incompatible with the original purpose of the Principles, which was to avoid prescriptive law-making.

PART 1: KEY MESSAGES

The 4th Edition introduces some important changes. The following are the key messages and takeaways for listed entities.

Board Responsibility, Culture and Values (Principles 1 and 3)

A Board Charter should delineate the respective roles of the Board and Management (Principle 1).

In particular, the Charter should state that the role of the Board is to:

- **define the entity's purpose and set its strategic objectives;**
- **approve the entity's statement of values and code of conduct to underpin the desired culture within the entity;**
- **satisfy itself that the entity has in place an appropriate risk management framework for both financial and non-financial risks;**
- **set the risk appetite to which the Board expects Management to operate; and**
- **satisfy itself that the entity's remuneration policies are aligned with the entity's purpose, values, strategic objectives and risk appetite.**

A listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and responsibly (Principle 3).

- **In particular, a listed entity should articulate and disclose its values.**

Articulating, socialising and measuring the culture, purpose and values of an ASX-listed entity now clearly fall to the responsibility of the Board and should be treated with the same priority as strategy-setting and risk management. In the 4th Edition, we continue to observe a clear shift towards greater accountability by the Board in setting corporate governance expectations which align with community standards.

There is now an expectation that Boards will conduct a robust self-assessment on how the entity is living up to its culture and its values, and ensure that the entity's strategy and risk appetite are measured against culture, purpose and values. Principle 1 clearly requires these matters to be emphasised and addressed in an entity's Board Charter.

For Boards to be able to adequately discharge their duties in setting and maintaining culture, they will need to be increasingly inquisitive of Management to ensure that the Board is receiving enough of the right information to measure the entity performance against its purpose and values properly. Executives should be encouraged to not simply ask whether an activity is allowed ("can we?") but whether it is ethical and appropriate ("should we?"). The 4th Edition is also very clear that this is an ongoing process. The rigour of compliance and self-assessment should be constantly revisited.

Similarly, reporting protocols within an organisation will need to be expanded to report up to the Board on these matters, and any material non-compliance should be dealt with at Board level. The Commentary makes it clear that Management should not only provide financial information but also information about its compliance with material legal and regulatory requirements, including any conduct that is materially inconsistent with the entity's values or code of conduct. This is consistent with the expectation that an entity's purpose is not solely to deliver financial returns but also to ensure it operates in accordance with its values, code of conduct and the risk appetite set by the Board.

Sustainable, long-term financial return of an entity is inextricably and positively linked to its having a clear set of values and purpose – and Principles 1 and 3 clearly reflect this proposition. While there are no set criteria for what should constitute an entity's purpose, it can no longer be short-term, myopic financial return. As Larry Fink, CEO of BlackRock puts it, "purpose aligns focus and strategic discipline to drive long-term profitability". Likewise stakeholders are increasingly making decisions based on the social and ethical responsibility of entities, such as whether to purchase a product or service or to invest in the entity. It is clear that entities are expected to consider their purpose in line with wider corporate citizenship expectations.

Principle 3 recognises that values are the guiding principles and norms of an entity. In formulating its values, an entity should consider what behaviours are needed from its officers and employees to achieve sustainable value for its security holders. The Board and Management of listed entities are now tasked with instilling a culture of acting lawfully, ethically and responsibly, taking into consideration a broad range of stakeholders to maintain their reputation and standing in the community. ASX-listed entities should be developing and measuring a culture of sustainability, long-term successful and stakeholder objectives. Ultimately, this shift is consistent with the sentiment playing out in corporate Australia: that executives of for-profit entities cannot keep operating with limited vision focused primarily on short-term profits.

This emerging need is already being recognised. For example, Rio Tinto PLC (a dual listed company along with Rio Tinto Limited) "downgraded the focus on shareholder returns in favour of spruiking the company's commitment to sustainability" in its 2019 Annual General Meeting.[1]

Identification and management of risk (Principle 7)

A listed entity should establish a sound risk management framework and periodically review the effectiveness of that framework (Principle 7).

In particular:

- the entity should have a Risk Committee which should be of sufficient size and independence, and its members between them should have the necessary technical knowledge and a sufficient understanding of the industry in which the entity operates, to be able to discharge the Committee's mandate effectively;
- the Board should review the entity's risk management framework at least annually to satisfy itself that it continues to be sound;
- the Board should ensure the entity is operating with due regard to the risk appetite set by the Board; and
- the entity should disclose whether it has any material exposure to environmental or social risk, with particular attention to climate change, and if it does, how it manages or intends to manage those risks.

Consistent with the themes in the current regulatory environment, the 4th Edition of the Principles places significant importance on the Board's role in identifying and managing risk. The 4th Edition changes also reflect an expansion of the roles of the Risk Committee.

Composition and role of the Risk Committee

The composition of the Risk Committee is as important as its function. Recommendation 7.1 provides that the Risk Committee can either be a standalone Risk Committee, a combined Audit and Risk Committee, or a combination of board committees addressing different elements of risk. Regardless of the structure, directors who serve on the Risk Committee should have a strong understanding of the risks in the industry in which the entity operates. Without the proper industry and entity knowledge they cannot properly anticipate risk and set the risk appetite for an entity that is appropriate with the entity's culture and values. The different Board Committees also need to ensure that they communicate with each other in order to avoid siloing. This issue of siloing was also raised in the Report of the Prudential Inquiry into CBA.

The expansion of the role of the Risk Committee in the 4th Edition recognises that, overall, Boards need to be more active than they currently are in an entity's risk management. Management is now required to report to the Board on new and emerging sources of risk (discussed below) and have the risk controls and mitigation measures in place to deal with those risks.

[1] The Australian Business Review, "Rio pitches sustainability plan at AGM" <https://www.theaustralian.com.au/business/mining-energy/rio-pitches-sustainability-plan-at-agm/news-story/03024580b5cd6f5260db7d52c1bc363a>.

Financial and non-financial risks

While the term "social licence to operate" in the Consultation Paper has since been removed, its themes (for example, requiring Boards to think beyond short-term financial return and risks, including consideration of reputation and community expectation), and those of the Final Report on the Financial Services Royal Commission, are still prevalent in the 4th Edition.

The 4th Edition now expect Boards to also consider non-financial risks. There are several key changes in this respect, including the introduction of "social risk" in Recommendation 7.4, which relates to the risk of negative consequences to a listed entity if it or its activities adversely affect society. The examples given are broad and include risks arising from the entity or suppliers engaging in modern slavery or aiding human conflict, as well as mass migration and pandemics.

The Principle recognises that contemporaneous and emerging risks are increasingly becoming a serious threat to profitability. The Council identifies risks, such as those arising from digital disruption, cyber-security, sustainability and climate change. Taking climate change as an example, there is a shift in the way it is being viewed, from being an ethical or moral issue to one that, if handled poorly, can lead to reputational, and consequently financial risk. **Practice Note:** The Commentary in Recommendation 7.2 contemplates that an entity might have to operate outside the risk appetite set by the Board; if so, the matters should be brought to the Board's attention. A situation where this may arise is when an entity acquires a business division of another entity for sound commercial reasons, but it assesses the risk management of that business to be inadequate in relation to its own, and must bring it into line. In these circumstances, having a Board with expertise in the entity and industry will be crucial.

Disclosure of material exposure

There is also focus on the requirement of disclosure where a listed entity has a material exposure to a non-financial risk. The Principles recommend that entities benchmark their disclosure of environmental or social risk against that of their peers. This requires Boards to have greater regard to the impact these non-financial risks may have on the entity. The Principles also adopt the Recommendation that listed entities with material exposure to climate change risk must consider implementing the Recommendations of the FSB's Task Force on Climate-related Financial Disclosures.[2] This reflects increasing pressures from stakeholders and interest groups to report in line with international standards.

Practice Note: Entities, particularly big emitters, will need to be asking themselves whether there have been any exposure to non-financial risks such as environmental, sustainability, climate change, in the relevant reporting period in order to make the proper disclosure. This requires entities to have proper measures for identifying exposure to these types of risk. Boards will need to continue to review their risk management frameworks at least annually to ensure that they are be sound.

Remuneration (Principle 8)

A listed entity should remunerate its executives to attract, retain and motivate high quality senior executives and in line with the entity's values, culture and risk appetite in the short-, medium- and longer-term (Principle 8).

In particular:

- remuneration is a key driver of culture and a key focus for investors; and
- when setting the level and composition of remuneration, a listed entity needs to balance its desire to attract and retain high-quality directors and senior executives against ensuring that the incentives encourage its growth and success without rewarding conduct that is contrary to its values or risk appetite.

[2] The Financial Stability Board's (FSB) Task Force on Climate-related Financial Disclosure is an internationally recognised body responsible for developing Recommendations for voluntary climate-related financial disclosures that are consistent, comparable, reliable, clear, and efficient, and provide decision-useful information to lenders, insurers, and investors. The FSB Task Force comprises of 31 members from across the G20 countries. The Final Report on Recommendations on Climate-related Financial Disclosures can be accessed here: https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf .

Key takeaways

1. Executive remuneration frameworks should place a stronger emphasis on non-financial metrics in assessing executive performance.
2. Deferring entitlement to executive remuneration incentives aligns with long-term performance.
3. Malus and Clawback of remuneration provisions in long-term performance incentives are underutilised and have the potential to play an important role in ensuring that non-financial outcomes are taken into account.

Greater role of non-financial metrics

The Recommendations in Principle 8 create a challenge for entities: how should they align executive remuneration with their values, culture and risk appetite along with financial targets in the short-, medium- and longer-term?

In the Final Report of the Financial Services Royal Commission, APRA Chairman Wayne Byres criticised the current structure of long-term variable remuneration in Australian entities as being "out of step with how best practices in remuneration are evolving internationally".[3] In particular, he noted that Australian executive remuneration models did not have enough focus on non-financial metrics when assessing performance hurdles for long-term incentives.

The rationale is that having high-performing non-financial measures not only aligns with entity values and risk management, but also drives long-term profitability. Wayne Byres also considers that Boards need to be more accountable in exercising discretion when assessing and rewarding executives on their performance, and calls for greater transparency in Board decision-making and less formulaic approaches favoured by investors.[4]

However there are concerns about how non-financial metrics can be implemented in practice. Boards have generally not been so accommodating as to shift their practices, and the investment community is divided over promoting the right kind of behaviour – and doubting it can be practically implemented. For example, one industry fund has considered that "it will be difficult getting into the detail of what to measure and how to measure it", with the Board needing to make more subjective decisions.[5]

Similarly, it appears shareholder consensus on the matter could be difficult to obtain, given the varying opinions on the matter held by large and small investors in the past. When presented with changing executive remuneration frameworks, shareholders have been surprisingly resistant to such a change. For example, the Commonwealth Bank of Australia attempted to do so in 2016, only to be rejected by shareholders; two years later, NAB's similar proposal was rejected by 88% of its shareholders.

[3] 'Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry' < https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf> at p. 353.
[4] Wayne Byres, "The Incentive to Fly Safely", the AFR Banking & Wealth Summit 2018, Sydney <https://www.apra.gov.au/media-centre/speeches/incentive-fly-safely>.
[5] Joanna Mather and Sally Patten, "A Seat at the Table", (April 2019) Australian Financial Review Boss Magazine 19.

Deferral of long-term incentives, Malus and Clawback

Perhaps a way to manoeuvre the difficulties of non-financial metrics and still promote the right kind of behaviour is not to dangle the carrot but to threaten with the stick. Entities can give effect to Principle 8 by employing policies relating to the deferring of entitlements to receive long-term incentives and by introducing a tighter policy around Malus and Clawback.

The Commentary in the 4th Edition Recommendation 8.2 introduces for the first time guidance for entities to disclose their policies regarding the reduction, cancellation (**Malus**) or Clawback of performance-based remuneration in the events of serious misconduct or material misstatement in financial statements. While this is an overall highly positive addition to the Principles, the Recommendation only refers to serious misconduct or material misstatement of financial statements as situations warranting Malus or Clawback. This is unlikely to be broad enough. For example, the policy applied by ASX Limited, as disclosed in its Clawback Policy[6], is that Clawback should apply "anywhere where adverse outcomes have arisen during a performance based remuneration period that warrants a reduction or reassessment of the original assessment of performance" and if "any other circumstances occur which the Board determines in good faith to have resulted in an inappropriate benefit".[7]

Introducing or strengthening an entity's current Malus or Clawback practices ensure that inappropriate conduct is not rewarded and can be a strong deterrent for misconduct, yet they are underutilised for a variety of reasons. First, some entities either do not have them or, where they have them, do not use them. Secondly, the exact details of the provisions are often not publicly available to investors (other than a blanket statement that the Board has a discretion to adjust rewards).

Recommendation 8.3 considers that a well-designed, equity-based remuneration, especially when linked to hurdles that are aligned to the entity's short-, medium- and long-term performance objectives, will be highly effective. Deferring executive remuneration can help avoid short-termism or the taking of undue risks.

Judging the performance of non-financial metrics in long-term incentives is not without its challenges. Given long-term incentives are intended to measure performance over a period of 3-4 years, it is not surprising that the vesting of these are traditionally based on financial outcomes.

Practice Note: As discussed above, implementation of this Principle and corresponding Recommendations is likely to provide significant challenges to ASX listed entities. The Remuneration Committees and Boards of those entities will need to rethink their approach to remuneration policies and practices in light of them.

[6] ASX Limited, ASX Clawback Policy, https://www.asx.com.au/documents/about/ASX_Clawback_Policy_Aug14.PDF.
[7] Ibid.

PART 2: MISSED OPPORTUNITIES

We consider the following Principles and Recommendations as missed opportunities to provide leading guidance on increasingly important and challenging issues faced by listed entities. They will require further clarification and, we expect, will continue to be subject of ongoing discussion.

Diversity (Recommendation 1.5)

Recommendation 1.5 says that a listed entity should have and disclose a diversity policy, and through its Board or a committee of the Board, set measurable objectives for achieving gender diversity in the composition of its Board, senior executive and workforce generally. In addition, an entity needs to make disclosure on the measurable objectives set for that period to achieve this and the entity's progress in achieving those objectives.

The conversation about diversity and inclusion in Australia, and globally, is evolving at a steady pace. Given the 4th Edition of the Principles is expected to apply for several years, it may be a missed opportunity to accelerate diversity and inclusion in the business world. As such, we query if an entity that adopts Recommendation 1.5 will actually fail to meet community expectations for diversity in 2020, given that many of the gender targets set by the Principles can be readily achieved in the short term, and the evolving concept of diversity and inclusion.

Targets

The introduction of a gender target for Boards is a standout change in the 4th Edition. However, voluntary targets are not new and not uncommon in both the public and private sector; indeed we know that as of 31 December 2018, 29.7% of ASX200 companies had already achieved 30% female representation. The challenge is therefore encouraging a goal of gender parity for those Boards and also encouraging **all** listed companies (ie. beyond the ASX300 and small Boards) to improve their composition.

While a 30% target has credibility as a tipping point, a 40:40:20 approach is gaining traction (40% women, 40% men and 20% flexible). The Australian Government, for example, is committed to achieving women and men each holding at least 40% of Government Board positions, with women holding overall 50% of Government Board positions.

Recommendation 1.5 makes it clear that "measurable gender objectives" are not only for senior executives, but required throughout the organisation's workforce. This encourages listed entities to promote greater participation in leadership by women with operational expertise, which ultimately paves the way for their participation in Management and Board appointment. In our view, this complements the growing pressure for entity and industry expertise on Boards discussed in Principle 2.

Beyond gender

There is a growing body of evidence on the benefits of embracing broader themes of diversity (such as cultural diversity or sexual orientation), although the Recommendation did not venture further than gender diversity. As a result, the Consultation Draft prompted feedback on the lack of a formal Recommendation on cultural diversity on the Board or workplace. While some additional tweaks were made, the Council has shied away from anything more prescriptive.

A progressive approach would have been to broaden the "measurable objectives for achieving gender diversity" to "measurable objectives for achieving gender and cultural diversity". This does not mandate cultural diversity targets per se, but nurtures actions which will vary from entity to entity. While there is no cultural diversity regulator akin to the Workplace Gender Equality Agency (**WGEA**) operating in the background, several ASX listed companies already specifically disclose their approach to cultural diversity and offer useful insights on what activity drives an improvement. For guidance beyond gender, helpful resources are available on websites such as those of the Diversity Council of Australia[8] or the Australian Human Rights Commission[9].

[8] https://www.dca.org.au/
[9] https://www.humanrights.gov.au/

Diversity, inclusion and decision-making

Related to this idea, it is interesting to note that the Commentary in Recommendation 1.5 touches on the role of diversity in decision-making[10], a theme indirectly flagged in the Final Report of the Financial Services Royal Commission. In discussing the need for greater supervision of organisational culture by APRA, Commissioner Hayne endorses the FSB's Toolkit[11] to mitigate misconduct risks. The FSB identifies key cultural drivers that can undermine the effectiveness of governance frameworks, and lists lack of diversity and inclusion resulting in groupthink, lack of challenge and debate and lack of psychological safety, amongst others. In our view, there is a nexus for organisations to explore further.

Composition of the Board (Principle 2)

The Board of a listed entity should be of an appropriate size and collectively have the skills, commitment and knowledge of the entity and the industry in which it operates, to enable it to discharge its duties effectively and to add value (Principle 2).

Board skills, commitment and expertise

Principle 2 proposes that the Board of an ASX-listed entity should "collectively have the skills, commitment and knowledge of the entity and industry" in which it operates. The 4th Edition has added the word "collectively" which was largely in response to submissions by stakeholders to the Consultation Draft suggesting that the proposed wording in the Draft required all directors to have this expertise.

The introduction of the concept of a Board "collectively" having the requisite skills reflects the predominant practice of ensuring that a Board comprises of individuals with a range of relevant backgrounds, skills and diversity. However, overall the Council has missed a timely opportunity to reinforce the importance of having directors with strong expertise about the entity and industry in which it operates.

The Financial Services Royal Commission's Interim Report had precipitated a growing concern that Boards may not be properly performing their oversight function over Management, largely from a lack of subject-matter knowledge or professional expertise amongst the directors. Increasingly entities are under strong pressure from investors to have directors with industry expertise, who can bridge information gaps, better absorb industry shocks and challenge Management where necessary.

Under Recommendation 7.2 the Board is to monitor the adequacy of the entity's risk management framework and satisfy itself that the entity is operating in line with its risk appetite, including that the framework adequately deals with contemporary and emerging risks. We suggest that a member of a Board is unlikely to properly perform this function unless he or she has a thorough understanding of the business and industry in which it operates.

Board Skills Matrix

Recommendation 2.2 relating to the Board Skills Matrix is a missed opportunity to encourage Boards to critically evaluate their current skillsets and encourage meaningful disclosure to investors.

The Consultation Draft had prescribed that Boards should:

> "either set out the mix of skills that the Board currently has or the mix of skills that the Board is looking to achieve in its membership.
>
> In the former, the Board Skills Matrix will usually take the form of a table listing all the skills the Board thinks it should have and indicating the presence or absence of those skills among existing Board members.

[10] It is also interesting that earlier editions of the ASX CGC Principles and Recommendations included Diversity under Principle 3: "Promote ethical and responsible decision-making".

[11] "Strengthening Governance Frameworks to Mitigate Misconduct Risks: A Toolkit for Firms and Supervisors", <http://www.fsb.org/wp-content/uploads/P200418.pdf>.

> In the latter, the Board Skills Matrix is likely to be in the form of a statement rather than a table which makes clear that it is a description of the mix of skills the Board is looking to achieve in its membership and not a representation of the existing skills the Board has. It should also summarise the steps the Board is taking to acquire those skills".

This Commentary has not been adopted and instead entities are directed to the Governance Institute of Australia (**GIA**) Good Governance Guide fact sheet linked in a footnote. In our view, the result of this makes it difficult for entities to clearly know what a thorough assessment of the Board's required skills might involve, which creates the risk that entities produce a boilerplate statement about the existing skills. In our view, entities should carefully consider the GIA's guidance on Board Skills disclosure.

Focus on upskilling and continual professional development

Recommendation 2.6 requires a listed entity to have a program for reviewing any need for existing directors to undertake continuing professional development. As the required skills and expertise required of a Board can change, any deficiencies in knowledge or expertise should be identified by the Board Skills Matrix and addressed.

This Recommendation emphasises the importance of the currency of a director's skills and knowledge for proper performance of their functions. If a director is deficient in some aspect of their knowledge or core professional skills, this would weaken their ability to monitor Management.

Independence

The substance of the Recommendations for identifying independent directors has remained the same following the 4th Edition, but debate remains over whether an independent director who has been appointed as the acting Chief Executive Officer of an entity can regain their independence following cessation of that role.

Under the Recommendations, the guiding principle remains that the Board should only rule a director to be independent if it is satisfied that any interest, position or relationship applicable to that director is not material and will not interfere with the director's capacity to bring forward an independent judgment.

PART 3: ENHANCING BEST PRACTICE

The 4th Edition has made important changes including adding new and improving existing Principles and Recommendations to enhance overall best practice by listed entities. The following are some noteworthy changes.

Integrity of corporate reporting and balanced disclosure (Principles 4 and 5)

A listed entity should have appropriate processes to verify the integrity of its corporate reports (Principle 4).

A listed entity should make timely and balanced disclosure of all matters concerning it that a reasonable person would expect to have a material effect on the price or value of its securities (Principle 5).

Principles 4 and 5 deal with safeguarding the integrity of corporate reports and ensuring the timely and balanced disclosure of price sensitive information to the market. They largely reflect existing best practices, but there are some welcome changes in the 4th Edition which promote better practices in corporate reporting. One significant example is the new requirement in Recommendation 5.3 for an entity to release on the ASX Announcements Platform beforehand the presentation materials it intends to give to a new and substantive investor or analyst.

Audit Committee

Recommendation 4.1 provides guidance to listed entities on the composition and roles of the Audit Committee. As the Recommendation currently stands, the Audit Committee "must have between them, accounting and financial expertise and a sufficient understanding of the industry in which it operate". In our view, the Recommendations should hold the Audit Committee to a higher standard and require each member to have accounting or financial knowledge, and the Chairman to have significant and relevant accounting expertise. This is critical for the Committee to make meaningful Recommendations on financial matters, which require a deep understanding of accounting principles and financial literacy.

Additionally, entities with an insufficient number of qualified directors for the Audit Committee should look for appropriate candidates, rather than appoint underqualified existing directors, to meet the size and independence requirements of the Committee.

An existing Recommendation worth revisiting relates to the role of the Audit Committee in reviewing and recommending any proposal for the external auditor to provide non-audit services, and whether it might compromise the independence of the external auditor. It is uncertain how often this actually occurs in practice or if this Recommendation is fully observed. Nevertheless Audit Committees of listed entities should take note of this requirement and not hesitate to make Recommendations to the Board where appropriate.

On top of these roles, additional roles have been included in the 4th Edition such as reviewing and making Recommendations in relation to the adequacy of the entity's internal control framework and the fees payable to the auditor for audit and non-audit work. Both Recommendations encourage good practice and transparency in the entity's corporate processes.

Practice Note: An increasingly common practice is for the entire Board to attend Audit Committee meetings before the entity's financial results are released, including those for reviewing the draft financial statements and the final meeting before Board approval. This is intended to facilitate a thorough understanding by all Board directors of the financial results and the matters which have or may impact on them and is to be commended.

Verifying the integrity of corporate reports

New Recommendation 4.3 requires a listed entity to disclose its processes in verifying the integrity of any corporate report it releases to the market that has not been audited or reviewed by an external auditor. This Recommendation aims to provide greater confidence to investors relying on a broader range of periodic corporate reports than audited or reviewed financial statements, such as quarterly activity reports, quarterly cash flows reports and the entity's annual directors' reports. This Recommendation is consistent with the greater disclosure requirements proposed by the ASX Public Consultation Paper on the Listing Rules, issued on 28 November 2018.

Practice Note: Recommendation 4.2 reflects the CEO's and CFO's obligation under section 295A of the Corporations Act 2001 (Cth) to make a declaration that the financial statements are compliant with accounting standards and represent a true and fair view of the company's financial position. Unlike the Corporations Act where the declarations need only be made in relation to annual financial statements, Recommendation 4.2 specifies that declarations must be made by directors before Board approval for all financial statements for any financial period (for example, including half-yearly reports).

Timely and balanced disclosure

Principle 5 has been expanded and updated to be consistent with the continuous disclosure requirements in ASX Listing Rule 3.1, together with the stricter timing requirements proposed by the ASX Listing Rules Consultation Paper. Recommendation 5.2 in addition operates to ensure the equality of information among investors; it does this by requiring an entity to release to the market any presentation materials provided to new and substantive investors. The entity should consider providing security holders with the opportunity for presentation, for example via dial-in details or a live webcast. These Recommendations ensure smaller investors are not disadvantaged, and reflect good practice overall.

A further positive addition to Principle 5 is Box 5.1 which contains suggestions for the content of the continuous disclosure policy required by Recommendation 5.1. A good continuous disclosure policy should set out how the entity deals with potentially price-sensitive information and communications – initially with the ASX for release to the market where required, and then generally with the media, security holders and the wider community – to meet the ASX Listing Rules and ASX Corporate Governance Principles. Guidance for designing a disclosure policy can also be found in ASX Listing Rules Guidance Note 8.

Facilitating security holder engagement (Principle 6)

In line with Recommendation 3.1, a listed entity should ensure that the corporate governance section of its website includes links to a statement of the entity's values and, we suggest, its stated purpose, as well as existing disclosure requirements.

Recommendation 6.3 encourages listed entities to disclose how it facilitates and encourages participation at security holder meetings and endorses existing good practice. The Commentary notes that technology can be used to facilitate security holder meetings. Increasingly, entities are considering hybrid or virtual meetings to accommodate larger or geographically diverse security holders. It is generally accepted that hybrid meetings are acceptable under the Corporations Act, while the status of virtual meetings is not so clear. It is likely in this case the law has lagged behind technological developments.

Regardless, entities seeking to incorporate technology into their security holder meetings need to make sure that their corporate constitutions permit the use of electronic communication devices, and their online platforms are up to the task.

Recommendation 6.4 now requires a substantive resolutions at a security holder meeting is to be decided by a poll rather than, as it is being increasingly done, a show of hands. This is a better implementation of the "one security one vote" principle.

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