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# Essential Director Update:16

Your duties. Your update.

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THE ESSENTIAL DIRECTOR UPDATE:16

## Agenda

- Corporate Culture
- Director Independence
- Risk Management
  - Risk Committees
  - Shareholder Activism
  - Tax Risk Management
  - Honest Director Defence
- Diversity on Boards
- Digital Disruption
- Brief Regulatory Updates
- Not-for-Profit Developments

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## Board responsibility for corporate culture

- **Recent cases**
  - Target revenue recognition fraud
  - Bank reference rate manipulation
  - BHP / Samarco tragedy
  - VW emissions fraud
- **Should directors bear civil (or criminal) liability?**
- **Focus by ASIC and APRA**
  - ASIC — seeks enforcement powers where 'bad culture' leads to breach of law
  - APRA — board confirmation of sound risk management culture (CPS 220)



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## VW Case Study

- Surely the board didn't know!
- Germany's two-tiered governance model:
  - Management board with Chair / CEO
  - Supervisory Board, appoints management
- What did management / CEO / boards know?
- What did they do?
- Cost: \$20 billion and counting



## ASIC v Cassimatis (August 2016)

- S.180 duty of care and diligence case against Storm Financial directors
- Duty of care to protect the company from harm, including reputational harm
- Storm's high risk financial advice breached Corporations Act and directors "should reasonably have known" this would harm the company
- S.180 is private duty owed to the company, but also a public duty
- Sole director–sole shareholder defence rejected
- Opens door to wider director liability?

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## ....But what should directors do about corporate culture?

- **Set tone-from-the-top**
  - Articulate values / expectations
  - Monitor a range of metrics
  - Ensure consequences for breach
- **Engage with cross-section of employees**
  - Spend time outside the boardroom
- **Remain alert — smell the smoke!**
  - Ask the right questions
  - Pay incentives align with values?
  - How are complaints handled?
  - Does bad news travel quickly to the board?

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## Do independent directors add value?

- **Article of faith in Australian governance**
  - ASX CGC recommendations / AICD policy
  - Numerous reviews, here and abroad
  - Industry super fund board proposal
- **But conflicting academic research**
  - Swan's analysis: more informed and incentivised directors is better
  - Frino analysis supports NEDs
- **But correlation is not causation**



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## Do independent directors add value?

- **US investors are catching up**
  - Open letter from Buffett, Dimon, Fink et al
  - 'Truly independent boards are vital to effective governance'
  - 'Diverse boards make better decisions'
  - 'Every board needs a strong leader who is independent of management'
- **Independence is a necessary but not sufficient qualification**
  - Diligence and application
  - Sound business judgement
  - Robust collegiality
  - Constant curiosity
  - Courageous integrity

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## Should your board have a Risk Committee?

- **ASX Principles now recommend a risk committee (7.1)**
  - Standalone or combined
  - To review RM 'framework'
  - Clear charter, independent directors
- **Typical responsibilities cover:**
  - OH&S / WH&S risk
  - Environmental risk
  - Regulatory compliance
  - Cyber / systems / fraud risk
  - Treasury / funding risk
  - Risk appetite / controls
- **Committee's proper role: assist the board fulfil its responsibility...**
  - Ultimate responsibility rests with the board



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## CSR activism

- **A challenge for boards and fund managers**
  - Divestment risk for listed companies
  - Litigation risk
  - Pressure on lenders
- **Shareholder-proposed resolutions at CBA, AGL and Origin**
  - CBA – direct company to report on customers' GHG emissions
  - Or change constitution to require report
- **CBA case clarifies role of board**
  - S198A ... business of company to be managed 'by or under the direction of the directors'
  - Shareholders have 'no part of play' in the board's exercise of its power
    - ... but how far can directors delegate to management?

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## Tax risk management

- **ATO tax risk Governance Review Guide**
  - Buck stops with the board
  - Endorse tax risk management policy
  - Recommends regular control testing
- **Voluntary Tax Transparency Code**
  - Enhanced public disclosures
  - \$100 million + turnover:
    - Effective tax rate, home and away
    - 'Reconcile' accounting profit and tax paid
  - \$500 million + turnover:
    - Tax strategy (incl. ATO 'dealings')
    - Federal, state and local taxes

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## Tax risk management

- **Multinational tax avoidance**
  - Diverted profits tax (Google Tax)
  - Stronger transfer pricing scrutiny
  - Panama papers aftermath



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## Honest and reasonable director defence

- **Australia's 'draconian' insolvency laws**
  - Personal liability when company trades when insolvent
  - Unable to pay debts as and when due
  - Reynolds' wine case
- **Renewed interest in protecting honest and reasonable director**
  - Government's Innovation agenda
  - Treasury Discussion Paper
  - AICD response, not unanimously supported
- **A broader 'safe harbour' defence is merited**
  - Beyond insolvency
  - But will this reform be once again stillborn?



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## Gender diversity on boards

- **ASX 200 female directors**
  - Up from ~10% to 24% from 2009 to 2016
- **Female appointments at 40% June 2016 YTD**
  - AICD targets 30% by 2018
  - Australian Chapter of the 30% Club
  - Continues Chair's mentoring program
- **'Cognitive diversity'**
  - Not just gender or ethnicity
  - Give me business-savvy directors (Warren Buffett)
  - With courageous integrity!



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## 'Digital disruption' – threat & opportunity!

- **Accelerating innovation**
  - Driven by plummeting cost of computer power
  - 'Big data' / data analytics / industrial analytics
  - Sensors / predictive algorithms
  - Machine learning / cognitive computing
- **Revolutionary business models**
  - AirBnB / Uber / Blockchain
  - New risks but also strategic opportunities



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## Director education on digital technologies is essential

- Invest board time
- Invite 'experts' to the board
- Consider 'Chief Disruption Officer'
- Create partnerships
- Maybe recruit expert director
- ... but beware 'deference risk'



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## Regulatory developments

- **Harper review**
  - New round of microeconomic reforms
  - Section 46 effects test controversy
  - Strengthened ACCC process and penalties
- **Enhanced audit reporting**
  - Applies to listed entities (15/12/16)
  - Key Audit Matters (KAMs) for listed entities
  - Post-Centro practice
- **ASIC enforcement — Prime Trust**
  - ASIC lost on appeal
  - Resolved on 19/7/2010 but lodged with ASIC on 23/8/2006
  - Breach of duties case filed 22/8/2012

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## Regulatory developments

- **Cartels / Misuse of Market Power Cases**
  - ACCC lost egg producers case (no agreement)
  - Also lost Flight Centre (agent is not competitor) and Pfizer case (no market power)
  - But won Renegade Gas (agreement not to quote)
  - Lesson: remember Volkswagen
- **Unfair Contracts (12 November 2016)**
  - Courts can void unfair contracts
  - Small firms < 20 employees
  - < \$300,000 (\$1 million over 12 months)
- **ANZ late fees case**
  - Not a penalty
  - Not 'out of all proportion' to costs
  - Not unfair or unconscionable



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## Non-profit sector developments

- **ACNC survives: new rules for 54,000 charities**
  - Charities passport will now develop
  - 500,000 other NFPs still state / ATO regulated
- **Uniform regulation?**
  - MOUs with states
  - WA and ACT legislated to exclude advocacy bodies
- **New 'Open Market' approach to government funding**
  - Eg. Aged care and disability
  - More competitors, new entrants
  - Need for new skills on NFP boards



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## In conclusion: Does a company have a culture?

- A brand?
- A personality?
- An identity?
- A soul?

The Oklahoma Ligno and Lithograph Co ...



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Questions?