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Essential Director Update:15

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Table of Contents

Welcome from John Brogden, CEO 4

1. The Business Environment 5
   - Trends in Australian corporate financing 5
   - Globalisation and scrutiny of international tax arrangements 5
   - Micropreneurship 6

2. The Governance Landscape 8
   - The Company Directors Course 40th anniversary 8
   - The Australian Institute of Company Directors Governance Leadership Centre 8
   - ASXCGC Corporate Governance Principles and Recommendations 3rd Edition 9
   - GNDI Guiding Principles of Good Governance 9
   - The Honest and Reasonable Director Defence: A proposal for reform 10
   - CEO succession 10
     - Internal versus external appointment 11
     - The selection process 11
     - 14 succession risks 11

3. Risk Landscape 13
   - Technology 14
     - Cybercrime 14
   - Social media 15
     - Risks to watch out for 15
     - Managing risk – better practice 16
   - Real-time performance dashboards 16
   - Fraud 17
   - Intellectual property (IP) 17
     - New amendments to the law 18

4. Technology Trends 19
   - The Stone & Chalk initiative 19
   - Crowdfunding 19
   - Retail omnichannel 21

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The Internet of Things 22

Live streaming 23

5. Legal and Regulatory Developments 24

Abolition of the 100 members rule 24

ASIC updates 24

Collective action 24

Assurance on integrated reporting 25

Continuous disclosure 25

Updated ASX Listing Rules Guidance Note 27: Trading Policies 26

Revised Auditor Reporting Standards 26

Class actions in Australia 27

A steady increase in major claims but no 'explosion' 27

A broader range of claims 27

A broader range of defendants 27

A broader range of plaintiff firms 28

Most class actions are settled 28

Litigation funding in Australia 28

IFRS 15 Revenue from Contracts with Customers 29

The Australian Competition and Consumer Commission 30

Cartels 30

Government procurement 30

Case study: Fortescue 31

Product safety 31

Case study: cots 32

Truth in advertising 32

Case study: free range eggs 33

Case study: Coles par baked bread products 33

6. Government Reviews 35

APRA's response to the Financial System Inquiry 35

The Harper Review 36

Productivity Commission's discussion paper *Business Set-Up, Transfer and Closure* 37

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Welcome from John Brogden, CEO

It is great to welcome you to the AICD's 2015 Essential Director Update (EDU).

When I joined the AICD as managing director and chief executive officer this year, I had been a member for six years, but I had never attended this event. Now I know what I've been missing out on.

The EDU is one of the most valuable member services we provide.

More than 4,560 members attended the EDU roadshow last year and 390 joined live webinars, making it the largest event of its kind for directors in Australia.

If you are attending the EDU for the first time, you will discover Alan Cameron's outstanding ability to provide insight into the changes that have occurred and the likely consequences we should all think about across the director and governance landscape.

Beyond the EDU, enhancing member service is a clear focus for the AICD. Our team is working hard to improve the relevance of what we offer to members who operate in diverse roles, including small business owners and directors of not-for-profit organisations. As a non-executive director (NED) myself, I am passionate about how AICD supports directors. This serves the economy and our community.

We are striving to be more responsive to issues of the day so that you have access to critical information when you need it most and have your voice represented on these issues.

I hope you find the information you hear today useful and builds on your knowledge and growth as a director.

John Brogden FAICD
Managing Director & CEO
Australian Institute of Company Directors

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1. The Business Environment

Trends in Australian corporate financing

Since the global financial crisis, the resources and non-resources sectors have produced distinctly different trends in the corporate financing of Australian companies.

Resources companies have driven an increase in net investment, which has primarily been funded through internal sources. Net external funding in the post-crisis period has been very modest, and largely confined to debt raisings by resources companies as variability in commodity prices over recent years caused fluctuations in the availability of internal funding. Capital structure within the resources sector has changed modestly as a result, raising leverage to around its average level since 2000; this is consistent with the low relative costs of debt, compared with equity issuance.

In contrast, net investment by non-resources companies has been mostly confined to sustaining the existing asset base. Internally generated funds have been sufficient to meet this expenditure, causing net external funding, and therefore capital structure, to remain stable in recent years. These companies have lifted dividends, though not beyond historical norms as a proportion of earnings.

Signs of slowing net investment by the resources sector highlight the importance of non-resources companies in driving future investment and demand for external financing; at present, these companies generally appear financially well-positioned, given their robust earnings and relatively low leverage, but as yet seem to have lacked the necessary catalyst to undertake this expansion.

Ashley Fang, Mitch Kosev and David Wakeling
Reserve Bank of Australia

Globalisation and scrutiny of international tax arrangements

A perfect storm has formed in the face of globalisation. The ever-growing digital economy, legacies from the global financial crisis and mounting deficits, coupled with highly sophisticated tax structures and the coordinated approach of revenue authorities around the world, have significantly increased scrutiny on international tax arrangements.

With the global movement of monies, governments around the world are clamouring to recover their fair share of tax. In an attempt to introduce some equity and structure into the debate, the Organisation for Economic Co-operation and Development (OECD) launched the Base Erosion and Profit Shifting (BEPS) initiative in 2013.

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Cynicism, lukewarm US participation and national imperatives have resulted in some jurisdictions introducing further localised initiatives spanning from early adoption of the OECD BEPS initiatives (e.g. Australia and 'country-by-country' reporting) to more controversial measures, such as the Diverted Profits Tax in the UK.

We are at the start of a long journey as the world adapts to a new global reality and authorities around the world balance global equity against localised interests. The implication for global companies is a prolonged period of uncertainty and rapid change. There are, however, some certainties. Reporting and transparency requirements will continue to grow, while unusual tax structures and misalignment between financial and tax outcomes will continue to attract scrutiny. Governments around the world will increasingly coordinate their activity to analyse international tax dealings, arming revenue authorities with sophisticated tools and the authority to do the same.

Directors should not wait for new measures to take effect before acting. Failure to do so could result in unnecessary scrutiny, potential reputational damage and significant costs as scarce resources are tied up addressing queries from revenue authorities.

Instead, by proactively assessing the profile of their own organisations well in advance of the transparency measures coming into place, directors can identify and assess risks, address anomalies that may attract unnecessary investigation, and ensure they have proper documentation to support tax positions taken.

Consideration should also be given to the medium to long term management of these requirements through process, systems and controls, as well as a robust governance model for the identification, tracking and management of risks.

The best way to navigate a perfect storm is to be prepared. Don't wait for the storm to hit before acting.

Tony Katsigarakis
Commercial Director
Corporate Reporting Solutions
Wolters Kluwer

Micropreneurship

"Uber, the world's largest taxi company, owns no vehicles. Facebook, the world's most popular media owner, creates no content. Alibaba, the most valuable retailer, has no inventory. And AirBnB, the world's largest accommodation provider, owns no real estate."[1]

[1] 'The Battle is for the Customer Interface', Tom Goodwin, Techcrunch website, March 3, 2015: http://techcrunch.com/2015/03/03/in-the-age-of-disintermediation-the-battle-is-all-for-the-customer-interface/#.eybukh:7PuS

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Tom Goodwin, senior vice president of Havas Media, recently made this observation about four organisations with their roots in the collaborative economy, where goods and services are exchanged between individuals, instead of from business to consumer. These organisations simply provide the online platforms that bring individuals together.

The collaborative economy has already disrupted sectors such as music and media, while others, such as travel and traditional retail, are feeling the pressure. And the threat is no longer limited to basic services. Businesses now have access to millions of freelance workers all round the world with a full spectrum of computer and other digital skills. A surprising amount of professional knowledge can be broken down into segments that are routine enough to be performed by freelancers. For example, *The Economist* magazine has reported that InCloudCounsel can undercut big law firms by as much as 80 per cent simply by using freelancers to process routine legal documents.[2]

Jeremy Rifkin, the bestselling author of twenty books on the impact of scientific and technological changes on the economy, the workforce, society and the environment, says that no one in their wildest imagination ever imagined the possibility of a technology revolution so extreme in its productivity that it could actually reduce marginal costs to near zero, making products nearly free, abundant and absolutely no longer subject to market forces.[3]

Now some futurists are predicting that the collaborative economy could bring about change on the scale of the Industrial Revolution, with the end of the 'Era of Big Work' and the collapse of the traditional corporation.

[2] 'There's an app for that', *The Economist* magazine, January 3, 2015: http://www.economist.com/news/briefing/21637355-freelance-workers-available-moments-notice-will-reshape-nature-companies-and

[3] 'Jeremy Rifkin – The Internet of Things and the Next Industrial Revolution', Nick Smith, E&T magazine, July 14, 2015: http://eandt.theiet.org/magazine/2014/07/interview-jeremy-rifkin.cfm

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2. The Governance Landscape

The Company Directors Course 40th anniversary

In 1975, when AICD ran its first governance education program, the ASX didn't exist, there was no Corporations Act as we know it, and the insulated domestic economy was heavily regulated.

Skyhooks' *Living in the 70s* was the top album that year, and Pilot, Abba, Skyhooks, Sherbert and Captain and Tennille all had songs in the top ten. Peter Weir had a hit film with *Picnic at Hanging Rock*. And *Poor Fellow My Country* by Xavier Herbert won the Miles Franklin Literary Award. There's no need to consider hair and fashion styles from the time…

Today, the ASX has a total market capitalisation of around $1.5 trillion and Australian businesses compete in unpredictable, globalised markets. The dramatic shift in the economic environment has also altered the legal framework within which business entities operate. This has had profound consequences for directors of organisations such as charities and sporting bodies.

Clearly, today's directors are operating in a far more complex environment than their predecessors and, over the years, the AICD's governance education has evolved to reflect the changes. Today, over the equivalent of five full days, the flagship Company Directors Course covers ten modules including corporate law, financial literacy, decision-making and risk management.

In the year to 30 June 2014, more than 2,500 people graduated from the Company Directors Course, compared with an estimated 700 graduates from the fledgling program in the late 1970s. Back then, participants were almost exclusively directors of large public companies. Today, the course attracts directors from a wide variety of organisations, including small private companies, not-for-profit organisations and local councils.

Over the next 40 years, the pace of change is likely to increase as forces such as ESG, digital disruption, social media, cybersecurity, big data and globalised regulation continue to drive the evolution of both the course content and how it is delivered.

The Australian Institute of Company Directors Governance Leadership Centre

The Governance Leadership Centre is a local hub for world class governance. The centre has been established to create and curate leading content on key governance issues, including:

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- external environment impacts on board practices
- current and future governance practices
- governance driving organisational performance.

The centre champions new thinking through governance innovation and aims to work with key stakeholders, including boards, business groups, investors, academia and government in the ongoing quest to improve governance performance and outcomes.

The centre welcomes feedback on existing research and also proposals for new studies and initiatives.

ASXCGC Corporate Governance Principles and Recommendations 3rd Edition

The ASX Corporate Governance Council Principles and Recommendations were introduced in 2003. A substantially re-written second edition was released in 2007, and new recommendations on diversity and the composition of the remuneration committee were added in 2010.

Since the release of the second edition in 2007, there has been considerable focus across the world on corporate governance practices in light of the events leading up to, and during, the Global Financial Crisis. In response, a number of jurisdictions have adopted new legislation regulating corporate behaviour and/or upgraded their corporate governance codes.

Following a comprehensive review in 2012-13, the 21 members of the ASX Corporate Governance Council agreed that it was an appropriate time to issue a third edition of the Principles and Recommendations. The changes in the third edition reflect global developments in corporate governance since the second edition was published. The structure of the Principles and Recommendations was also simplified, which also affords greater flexibility to listed entities in terms of where they make their governance disclosures.

Alan Cameron AO
Chair, ASX Corporate Governance Council
27 March 2014

GNDI Guiding Principles of Good Governance

In May, the Global Network of Director Institutes (GNDI) issued a new perspectives paper to provide guidance to boards in good governance beyond legislative mandates.

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The *Guiding Principles of Good Governance* were developed as part of its commitment to helping further good governance and achieve a positive impact for companies, the economy and society.[4] The principles are considered good practice for effective governance and will enable organisations to create or refine effective governance systems.

The 13 principles are intended to provide organisations of all sizes and types with a starting point or guide for the development of their own governance arrangements, taking into account their particular circumstances. They cover a broad range of governance-related issues, including disclosure of practices, independent leadership and relationship with management, among others.

The Honest and Reasonable Director Defence: A proposal for reform

In August 2014, Company Directors published the policy paper: *The Honest and Reasonable Director Defence: A proposal for reform*. The paper outlines some of the unique challenges facing directors as a result of the Australian regulatory environment and suggests an Honest & Reasonable Director Defence that could be inserted into the Corporations Act as a way of restoring the risk-reward equation for directors and re-instating the ability of honest directors to make judgments on all aspects of their businesses without undue concern over personal liability.

The proposed defence, which was developed by AICD, would be available in circumstances where a director conducts him or herself honestly, for a proper purpose, and with the degree of care and diligence that the director rationally believes to be reasonable in the circumstances.

For example, the provision could apply to alleged contraventions of:

- directors' statutory duties
- strict liability offences
- continuous disclosure provisions
- misleading or deceptive conduct provisions
- insolvent trading provisions.

The defence would apply to all directors of companies regulated by the Corporations Act and, crucially, it would not lower the standards for directors.

CEO succession

The following is a summary of the recent paper produced after a round table discussion between chairmen and senior directors in Sydney.

[4] *Guiding Principles of Good Governance*, GNDI: http://www.gndi.org/

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Selecting the right chief executive officer is one of the board's primary responsibilities. Companies reflect the behaviours, objectives and strategies of the CEO, and many corporate disasters can be linked to a CEO who is inappropriate or a poor fit.

Some directors feel strongly that CEOs should serve a term of no more than six or seven years, while others point to the many CEOs who have been in the role for much longer and continuing to do an excellent job. However, as the average tenure of a CEO has now contracted to about four years, succession planning becomes an ongoing priority.

Internal versus external appointment

An internal appointment brings a number of advantages. For example, the board should have a good insight into an internal candidate's skills, abilities and leadership style. However, not everyone has the ability to make the quantum leap from managing a division to running the company. The fact that a candidate has 'grown up' within an organisation may even be a hindrance in that he or she is already part of the culture created by the departing CEO and might find it difficult to effect radical change.

Most CEOs appointed from outside the organisation have already held the position elsewhere, so they bring the benefits of experience and a visible track record. The most common problem is that even the most accomplished may not be a good fit in terms of performance or culture. And every external appointment is something of a gamble, with search consultants reporting a success rate of only about 50 per cent.

The selection process

For the board, the first steps of the selection process are to articulate a clear vision for the future of the organisation and then identify the skills needed to achieve that. These change over time; yet no matter how successful the current CEO is, the board may need to look for quite different abilities and specialisations in the next appointment, particularly if the business is facing major disruption to the business model.

The board should also be clear about the values they expect from a CEO, such as openness, honesty and transparency.

Most boards engage one or more search consultants to help them identify external candidates. Even if an internal candidate seems almost certain to be appointed, this is considered good governance.

14 succession risks

Korn Ferry recently published the results of a survey of prominent business leaders in Australia and New Zealand in *The Risky Business of CEO Succession,*[5] which identified 14 threats to a successful CEO succession process, which are as follows:

[5] *The Risky Business of CEO Succession*, Korn Ferry Institute, 2015: http://www.kornferryinstitute.com/reports-insights/risky-business-ceo-succession

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1. CEO involvement in choosing successor, including considering the feelings of the incumbent CEO to the detriment of the process
2. Commencing the process without first agreeing on the strategy for the company – and market factors – that impact the CEO role
3. Starting the process too late
4. Considering only internal candidates
5. Considering only external candidates
6. The succession process becomes a distraction for the senior executive team
7. Successors who aren't ready
8. When the process is conducted without human resources involved
9. Managing the process without professional advice from consultants or a search firm
10. When the board has little experience of CEO succession
11. The intervention of investors who are not on the board in CEO selection
12. When unsuccessful internal candidates leave the organisation
13. Lack of clarity between emergency and planned succession processes and actions
14. Lack of co-ordination with the chairman's succession and the impact on the CEO.

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3. Risk Landscape

The KPMG 2015 Global Audit Committee Survey identified economic and political uncertainty and volatility, regulation and the impact of public policy initiatives, operational risk, and cybersecurity as continuing concerns for boards, and audit committees in particular.[6] However, the accelerating rate of change and growing complexity of the business environment are also increasing the risks associated with an overloaded board agenda. Of the 1,500 audit committee members who participated in the survey, three out of four said the time required to carry out their responsibilities had increased significantly.

Boards are also concerned that they can no longer rely on the traditional planning process to steer the company through the next three to five years. Plans must be continuously reviewed and adjusted to keep pace with change, and it is no longer enough to view risk on the two-dimensional basis of likelihood and impact. The third dimension is interconnectivity between risks; boards must consider how quickly the impact of one event will flow through the business and ensure they have a well-tested risk management strategy that takes this into account.

For those dealing with emerging markets there is an increasing risk of convergence between the three major risks:

1. breach of regulations
2. bribery and fraud
3. reputational damage.

Banks and other financial institutions governed by the Australian Prudential Regulation Authority (APRA) are required to separate the risk committee from the audit committee and there are signs that this is gradually being adopted by organisations outside of the sector, including some mid-caps.

This was reflected in the recent changes to the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations 3rd Edition, which now requires ASX listed companies to disclose on an 'if not, why not' basis whether they have established a committee or committees to oversee risk (either as a stand-alone risk committee, a combined audit-risk committee or a combination of committees addressing different elements of risk).

Where the entity does not have a committee dealing with risk, it must disclose the processes it employs for overseeing its risk management framework.[7]

[6] Global Audit Committee Survey 2015, KPMG: http://www.kpmg.com/au/en/issuesandinsights/articlespublications/global-audit-committee-survey/pages/global-audit-committee-survey-2015.aspx

[7] Recommendation 7.1 of the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations 3rd Edition.

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Technology

Technology is driving almost every aspect of change within an organisation. Directors cannot anticipate exactly how digital disruption will play out in their organisations, and social media is having an impact in ways that no-one predicted. The use of data analytics and 'big data' has introduced new risks, which can play out on a massive scale, relating to what is or is not stored on the cloud. Cybercrime is a growing threat to profit and reputation; and the growing threat of personal liability is causing boards to be more wary of making tough decisions. Directors should be aware of the requirements of the revamped *Privacy Governance Act 1988*,[8] which came into effect on March 14, 2014; in particular, the implications it has for how private information is collected and stored electronically. To help directors navigate their way through these changes, AICD published *Privacy Governance: A Guide to Privacy Risk and Opportunity for Directors and Boards (2014) written by ex-privacy commissioner Malcom Crompton.*

Researchers have found that digitally mature boards with digital literacy, financially outperform their peers by 9 per cent, are up to 26 per cent more profitable, and have up to 12 per cent greater market valuation.

Yet, according to the 12th Annual Director Survey by New York Stock Exchange Governance Services published this year, 55 per cent of U.S. directors surveyed do not believe it is reasonable to expect that a public company board can ever fully get its arms around all the different aspects of risk in the current corporate environment, particularly the newer forms of technology risk like cyber risk and social media risk.[9] The report adds that this raises the question: Are boards today equipped to tackle all that is thrown at them, especially in these emerging, and largely unknown, risk areas?

Cybercrime

Cybercrime is increasingly affecting the lives of the Australians year after year. Cybercrimes are crimes that are:

- directed at people via their computers or other devices (for example, hacking)
- computers or other devices are integral to the offence (for example, online fraud, identity theft and the distribution of child exploitation material).

Common types of cybercrime include hacking, online scams and fraud, identity theft, attacks on computer systems and illegal or prohibited online content.

ASIC's major report[10] on cyber resilience, *Cyber resilience: Health Check*, defines this term as "an organisation's ability to prepare, respond, adapt and recover from a cyber attack". The report's "health check prompts" were created to help

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8 *Privacy Governance Act 1988*: http://www.oaic.gov.au/news-and-events/media-releases/privacy-media-releases/privacy-laws-change-tomorrow

9 'What Directors Think 2015', NYSE Governance Services: http://www.nyse.com/WDT2015

10 *Cyber resilience: Health Check* booklet, ASIC, 19 March, 2015: http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-060mr-asic-issues-major-cyber-resilience-report/

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businesses review their cyber resilience, including flagging relevant legal and compliance requirements, particularly on risk management and disclosure.

Social media

Risks

Social media (SM) enables two-way communication and collaboration online through social media networks, such as Twitter, Facebook, LinkedIn, Tumblr and other platforms. Organisations can (and have) utilised it to build a competitive advantage, generating business and engaging with their customers on a more personal level. Yet many may not realise the full potential of SM, or engage poorly, which could lead to missed opportunities and/or open them to a variety of risks.

For every SM marketing success, however, there are a dozen examples of organisations getting it wrong. A single public failure can have far greater ramifications than multiple successes. Boards and management teams must be aware of, understand, and manage the risks that online conversations may present to their business. This is especially important for listed companies, and includes the responsibility for continuous disclosure.

Handling grievances in a professional and considerate manner is critical to achieving a successful resolution for both the customer and the company.

This two way communication increases opportunities to connect with customers and prospects but also increases risk, especially as corporate regulators and bodies (such as ASIC, ACCC and the ASX) are already announcing compliance requirements and guidelines with respect to social media use.

A fundamental question you must ask is whether your marketing department or agency is aware of these guidelines – let alone the risks to reputation and your bottom line. Most SM activities will come from a marketing perspective, without necessarily including an eye to risk management, or significant governance issues, such as continuous disclosure.

Management must ensure the organisation comes together to capitalise on the opportunities SM presents but also heads of departments need to share responsibility for managing risk and training staff on how to do this in their day-to-day jobs. Directors will want to ask questions that relate to governance oversight.

Risks to watch out for

Social media risks fall under three main areas, and importantly, can accelerate traditional risks; these areas are as follows:

- **Operational risk** can involve:
  - Copyright
  - employee non-compete and confidentiality agreements

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    - monitoring employees on social media
    - questions involving who ultimately ‘owns’ the content you post on LinkedIn, Facebook, Twitter, etc.
- **Regulatory risk** is all about public-company disclosures and what official information is made public, when and by whom. If you tweet ‘great numbers’ before your actual numbers are released, what disclosure rules have you just broken?
- **Reputational risk** may be dealing with what you or your employees say online, as much as what others say about you (and how you react to that).

Additionally, SM can result in supply chain risk and business continuity issues through to intellectual property and confidential information leakage. These impacts are occurring at a speed and frequency that often catch many organisations by surprise. And once they are let loose, their impact can be crippling.

Managing risk – better practice

- Adopt a comprehensive SM strategy that outlines the requirements (and culture) of your business.
- Training is critical to ensure SM is an asset for your organisation, ensuring everyone is vigilant but collaborative about getting it right.
- Carry out an annual SM ‘health check/diagnostic’ to quantify exposures and provide recommendations on how to best address various identified risks.
- As the ASX suggests, utilise issues-based monitoring, in particular when market sensitive announcements are being made.
- Consider implementing appropriate monitoring during a crisis or as a precautionary measure when incidents or issues may occur.
- Include SM within your reporting framework – beyond marketing. A diagnostic report can also identify what measures need to be in place regarding your SM exposure and risk.

Ultimately, regardless of all of the procedures you put in place, there is one thing you need to do: be vigilant. Create a culture where everyone in your organisation understands how to protect your business brand and their own personal brand.

Gary Gill
Partner
Risk Consulting
KPMG

Real-time performance dashboards

The board may make decisions based on the information it receives and, until recently, that information was provided almost exclusively by management. Now growing numbers of directors are using digital dashboards to access up-to-date information and also to gain direct access to some data.

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A digital dashboard presents information at every level, from a summary to the detail in a graphical format that can be viewed on a computer or smartphone. It can provide the information in real time though, when the business is running smoothly. Most directors prefer to receive daily, weekly or monthly updates. And the cost can be surprisingly low; some very sophisticated software is OpenSource or Software As A Service (SaaS), so the company pays only for using the service.

Dashboards introduce the same kinds of security risk as any other digital process, and similar steps must be taken to mitigate these. In the first instance, operating through a virtual private network will ensure that all data is always encrypted.

Rodrigo Rubio
Principal Consultant and Co-founder
Akro Software Solutions

Fraud

The Australian Institute of Criminology reports that corporate fraud costs Australia some $8.5 billion a year and that the incidence is on the rise.[11] Fraud can undermine the performance of an organisation and damage the reputation of both the company and its directors. Last year, for example, when UK supermarket Tesco reported that its profits had been overstated by £260 million ($475 million), four senior executives were suspended, 20 per cent was wiped off the company's value and the Serious Fraud Office was called in to carry out a criminal investigation into accounting irregularities.

The Tesco case has raised some questions Australia's directors may want to consider:

1. Does the board have an appropriate mix of skills and experience? Tesco shareholders pointed to a lack of direct retail experience on the board.
2. Does the board set the tone of the organisation and actively encourage a culture of openness and honesty? Tesco executives were not only willing to exaggerate the figures, they were able to get them past the audit committee.
3. Is the board taking appropriate steps to address changes in the marketplace? Tesco's executive's actions might have been influenced by the fear of announcing just how much of their market share they were losing to Aldi and Lidl.

Intellectual property (IP)

There is a continuing rise in the number of companies whose value lies largely in intangible assets. These can include anything from software and inventions to processes and methodologies, as well as proprietary information, such as customer lists and pricing information. So, while directors still need to oversee

[11] Australian Institute of Criminology, 2011: http://www.aic.gov.au/crime_types/economic/fraud.html

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the use of traditional tools, such as patents, trademarks, design registration and copyright, they also need to be well-informed about risks associated with the new, non-traditional aspects of IP. This is particularly important for companies that rely on innovation for their competitive edge.

A good board will create an organisational culture in which IP is actively managed, which includes staff training, development, identification, and protection through to commercialisation.

Boards need access to a comprehensive and up-to-date audit of the company's IP, including:

- what is being developed
- whether it is being developed by employees or contractors
- where it is kept
- what the company owns
- how this IP is protected, both practically and legally.

This will enable them to decide how much time and money should be allocated to protecting it.

New amendments to the law

The *Intellectual Property Laws Amendment Act 2015*, which passed the Senate in February, was designed to simplify aspects of Australia's IP system, make it cheaper and easier to protect and enforce certain IP rights.[12]

According to the Hon Karen Andrews MP, Parliamentary Secretary to the Minister for Industry and Science, the new Act will streamline business between Australia and New Zealand by simplifying the process for innovators seeking to patent the same invention in both countries. Farmers, nursery owners and others who work with new plant varieties will benefit, as the plant breeders who supply these industries will now have simpler and more cost-effective means of enforcing their rights in the Federal Circuit Court. Generic drug manufacturers will also now be able to apply to Australia's Federal Court for permission to manufacture patented drugs and then export the medicine to a developing country facing a health crisis.

[12] The Hon Karen Andrews MP, Parliamentary Secretary to the Minister for Industry and Science, 'Less IP red tape for Australian business - more help for countries in need' press release, February 10, 2015: http://minister.industry.gov.au/ministers/andrews/media-releases/less-ip-red-tape-australian-business-%E2%80%93-more-help-countries-need

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4. Technology Trends

The Stone & Chalk initiative

Fintech is the term used to describe the delivery of financial services through technology. It is one of the fastest-growing sectors in the financial services industry globally – according to CB Insights data, global investment in fintech ventures reached $12.21 billion in 2014.[13]

Stone & Chalk is being set up in Sydney as an independent, not-for-profit and industry-led initiative to accelerate the development of world-class Australian fintech start-ups by providing a location for collaboration.[14]

Founding corporate partners include AMP, ANZ, KPMG, Macquarie Group, Suncorp, Westpac, Woolworths, HSBC, IAG, American Express, ASX, IBM, TAL and Reuter. The New South Wales government is providing support in the hope that Stone & Chalk will attract international fintech talent to Sydney, help to develop and support local industry and increase financial services innovation and exports.

Stone & Chalk's 2,300 square metre space in Sydney's CBD will accommodate up to 200 entrepreneurs with a combination of dedicated labs, full and part-time desks, secure offices and casual 'drop in' spaces. There will also be an events space for hosting master classes, meet-ups and conferences.

The Stone & Chalk fintech hub is consistent with recommendations in the 2014 Financial Systems Inquiry's Final Report which calls for a permanent public-private sector collaboration committee to be established comprising industry, government, regulatory, academia and consumers to facilitate system innovation and a more flexible regulatory framework.

Crowdfunding

Finding capital for a start-up or business expansion might soon be as simple as asking for crowd support.[15]

While crowdfunding is now a well-established way to raise funds for good causes and entrepreneurs, its use as a genuine investment vehicle has so far been unavailable in Australia for anyone other than wholesale and high net worth investors.

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[13] *The Future of Fintech and Banking: Digitally disrupted or reimagined*, Accenture and CB Insights, 2014: http://www.fintechinnovationlablondon.net/media/730274/Accenture-The-Future-of-Fintech-and-Banking-digitallydisrupted-or-reima-.pdf

[14] Stone & Chalk: http://stoneandchalk.com.au/

[15] This is an extract from *Attracting a crowd*, Company Directors magazine, September, 2014: http://www.companydirectors.com.au/Director-Resource-Centre/Publications/Company-Director-magazine/2014-back-editions/September/Feature-Attracting-a-crowd

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To date, campaigns run by entrepreneurs on crowdfunding websites offer a reward or service in return for a pledge of funds. But equity crowdfunding — through which individuals invest for a financial return — is expected to be allowed soon in Australia.

By formalising and extending the 'friends, family and fans' investor base, crowd-sourced equity funding could allow budding entrepreneurs to raise funds from investors worldwide, and get ventures off the ground.

A start-up entrepreneur, for example, might seek $30,000 to develop a new smartphone application, and receive an average $30 from 1000 investors. Also, the entrepreneur could use crowd-sourced equity funding to develop a deeper relationship with investors, who comment on the application's development, champion the idea to their peers via social media, and provide proof there is a market for the concept.

Dr Terry Cutler, principal of consulting firm Cutler & Company and president of CSIRO Chile, says equity crowdfunding is an exciting development for Australia. "It goes to the core of the perennial problem facing start-up entrepreneurs: lack of capital. I just hope the government does not regulate crowdfunding to death before it gets going."

Cutler likens crowd-sourced equity funding to other peer-to-peer internet platforms, such as the accommodation-matching service AirBnB or the car-ride-sharing service Uber. Here, the platform's reputation effectively self-regulates the market and keeps both sides of the transaction honest through rating services.

"From the mid-1990s on, governments have been cautious about over-regulating emerging activity on the internet – an approach that has paid off," says Cutler. "They recognised these markets must be allowed to develop and that you cannot take regulatory principles from offline markets and apply them to the internet."

Cutler prefers New Zealand's regulatory model for crowd-sourced equity funding. It started in April last year and the first intermediaries for crowd-source equity funding, PledgeMe and Snowball Effect, were licensed in late July. These platforms connect small companies seeking equity capital and small investors who want to buy their shares.

There's been some concern that Australia's new rules for equity crowdfunding will be too restrictive and based on recommendations by the now defunct Corporations and Markets Advisory Committee (CAMAC).[16]

In a recent presentation to the Commercial Law Association of Australia, Andrew Macpherson of law firm Macpherson Greenleaf said: "The CAMAC report is a helpful consideration of the issues, but proposes a too-restrictive regime for equity crowd funding."

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[16] The Financial System Inquiry included 'Recommendation 18' on the topic of crowdfunding: http://fsi.gov.au/publications/final-report/chapter-3/crowdfunding/

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The New Zealand approach places a greater onus on the licensed intermediary, in conjunction with the issuer, to determine the level of disclosure required by companies raising funds through equity crowdfunding. Moreover, the intermediary can have a financial interest in companies it promotes. New Zealand companies are limited to raising no more than $2 million from the public in any 12-month period.

Although CAMAC proposed a similar $2 million issuer cap, it puts more onus on the company, and by default its board, to disclose information to investors.

Unlike New Zealand, which has no investor limits, CAMAC suggested caps on how much retail investors could invest through equity crowdfunding: $2,500 per company per year, and no more than $10,000 a year.

This is an edited extract from 'Attracting a crowd', September 1, 2014, Company Director magazine.

Retail omnichannel

For the past six years The Australian Interactive Media Industry Association (AIMIA) has been working with the Australian Centre for Retail Studies at Monash University to track Australia's retail professionals for their view of digital transformation in the retail marketplace. Their 2014 report, *How Australian retailers are transforming the e-commerce marketplace*, found that online retailing remains a small part of the overall retail landscape, accounting for 5 per cent of global retail spending in 2013, but that it is an increasingly important component of the modern retail mix with retailers continuing to invest in online and digital channels primarily to connect and transact with consumers.[17]

Deloitte's 2015 'Global Powers of Retailing' report describes mobile retailing as a rapidly-growing business segment that is expected to approach US$640 billion in annual global sales within just a few years.[18] Wearables will offer new opportunities to engage consumers and payments via mobile are of growing importance. And Google's Consumer Barometer, a global survey of how different nations and regions engage with their smartphones, confirmed that Australians have one of the highest rates of smartphone ownership in the world.[19]

Many big retailers are working towards using a variety of sales platforms, from physical stores to online and smartphone apps, to provide customers with a seamless shopping experience, wherever and however they buy. However, a global survey by *The Economist* Intelligence Unit, *Creating a seamless retail customer experience*, found that many retailers have yet to carry out basic steps,

[17] *How Australian retailers are transforming the e-commerce marketplace*, AIMIA and Australian Centre for Retail Studies, Monash University, 2014: http://www.aimia.com.au/retail-research-report

[18] 'Global Powers of Retailing', Deloitte, 2015: http://www2.deloitte.com/au/en/pages/consumer-business/articles/global-powers-of-retailing.html

[19] Consumer Barometer website, Google: https://www.consumerbarometer.com/en/

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such as adapting their websites to mobile apps.[20] Few have hired a person to take overall charge of the customer journey or have unified their customer service across platforms, suggesting very little progress towards omnichannel retailing.

The Internet of Things

In 1999 Kevin Ashton coined the phrase 'the Internet of Things' to describe the network which connects objects in the physical world to the Internet.

"In the twentieth century, computers were brains without senses—they only knew what we told them," he recently told *Smithsonian* magazine.[21] "That was a huge limitation: there is many billion times more information in the world than people could possibly type in through a keyboard or scan with a barcode.

"In the twenty-first century, because of the Internet of Things, computers can sense things for themselves. It's only been a few years, but we already take networked sensors for granted. One example is GPS-based location sensing. Civilian GPS was first authorized by congress in 2000, and the GPS systems in cellphones were not tested until 2004. Yet it's already hard to imagine a world without GPS: it helps us find our way around. In the imminent future, it will enable things like self-driving cars, which will give us back the 20 days a year we spend doing nothing but driving, will save 40,000 lives a year in the US alone, will reduce traffic and pollution, and will allow cities to grow without devoting as much land to roads."

Along with the benefits come matters of serious concern. For example, Cisco estimated that the number of internet-connected devices reached 8.7 billion in 2012 and that, by 2020, there will be 50 billion such devices.[22] Each connection increases the risks associated with the collection and storage of the vast amounts of personal data needed for the system to function efficiently.

There are also broader social and ethical considerations. For example, teaming cognitive computing and robotics has exciting implications, but a study from Oxford University suggests that this level of computer automation could put the jobs of almost half of North America's working population at risk.[23] There are other scenarios to consider; for instance, what if a child runs in front of a self-driving car – should the vehicle's programming prioritise the life of the child or the driver? And furthermore, who should be allowed to decide?

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[20] *Creating a seamless retail customer experience*, *The Economist* Magazine Intelligence Unit, 2015: http://www.economistinsights.com/sites/default/files/Creating%20a%20seamless%20retail%20customer%20experience.pdf

[21] 'Kevin Ashton Describes "The Internet of Things"', Arik Gabbai, *Smithsonian* Magazine, January, 2015: http://www.smithsonianmag.com/innovation/kevin-ashton-describes-the-internet-of-things-180953749/?no-ist

[22] 'How many Internet connections are in the world? Right. Now.', Karen Tillman, Cisco blog, July 29, 2013: http://blogs.cisco.com/news/cisco-connections-counter

[23] *The Future of Employment: How Susceptible are Jobs to Computerisation?*, Carl Benedikt Frey and Michael A. Osborne, Oxford Martin, September 17, 2013: http://www.oxfordmartin.ox.ac.uk/downloads/academic/The_Future_of_Employment.pdf

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Live streaming

Live video streaming is not new but the Meerkat and Periscope apps launched this year attracted attention because they both make it far easier for users to capture and broadcast live video from their smartphones.

Some companies have identified opportunities to use live streaming to enhance their social media and digital marketing. However, the challenge for the board is identifying whether the commercial applications outweigh any potential risks. For example, everyone captured on a video filmed in a public place must give their consent for it to be used for commercial purposes. If they have not consented, they have the right to sue. There is also a physical security issue for some organisations: for security reasons, an organisation may not wish for others to know its staff and/or directors are all located at one venue.

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5. Legal and Regulatory Developments

Abolition of the 100 members rule

In March, the *Corporations Legislation Amendment (Deregulatory and Other Measures) Act 2015* came into effect removing the 100 member rule in section 249D(1)(b) of the Corporations Act. As a result of the abolition directors are no longer required to call a general meeting at the request of 100 members. However, they must still call a general meeting if asked to do so by members holding at least 5 per cent of the votes that may be cast at the general meeting.

The change will protect listed companies and many not-for-profits that are public companies limited by guarantee from having to convene extraordinary general meetings at considerable expense where there is limited chance of resolutions receiving a majority vote. The abolition of the rule will not impact the ability of 100 or more members still have the right to add items to the agenda of a general meeting, and the Act does not remove the equivalent 100 member rule for registered managed investment schemes.

ASIC updates

Collective action

ASIC has reviewed its regulatory guidance for investors who want to take collective action to improve the corporate governance of listed entities and released the updated Regulatory Guide 128 *Collective action by institutional shareholders* (RG 128) on 23 June 2015.

ASIC Commissioner John Price said that effective investor engagement underpins good corporate governance and promotes confident and informed investors and fair, orderly and transparent markets. "ASIC recognises that it can be efficient and effective for the market for investors to work together when engaging with a listed entity. But we do not want to promote behaviour that leads to control over an entity being acquired inappropriately. In our update we aim to provide guidance that facilitates investor engagement yet honours the spirit of takeover laws."[24]

Collective action by investors can give rise to compliance issues under the takeover and substantial holding provisions of the law. These provisions are concerned with the aggregated voting power of groups of investors who are either related to or

[24] '15-155MR ASIC updates guidance on collective action by investors', ASIC, June 23, 2015: http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-155mr-asic-updates-guidance-on-collective-action-by-investors/

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associated with some aspect of the entity's affairs. For instance, an agreement to vote together on a matter could result in an investor contravening the 20 per cent takeover threshold.

The revised RG128 now includes:

- updated guidance on how the takeovers and substantial holding notice provisions apply to collective action by investors, including illustrative examples of conduct which is unlikely or likely to trigger these provisions
- an outline of ASIC's proposal to approach enforcement in relation to these provisions by focusing on conduct that is control seeking rather than simply promoting good corporate governance
- an overview of other legal and regulatory issues that can arise in relation to investor engagement.

ASIC also discontinued the class order relief that was available to facilitate agreements between institutional investors about voting as it was considered to no longer be relevant and had not been used for many years.

Assurance on integrated reporting

In July 2014, the International Integrated Reporting Council (IIRC) released a paper, *Assurance on Integrated Reporting, an exploration of issues* with the aim of helping stakeholders to understand the role of assurance on integrated reporting and initiating a global discussion on its benefits and challenges.[25]

In its submission,[26] AICD stated that, in its view, significant additional work is required, not only by the IIRC but other standard setters including the International Auditing and Assurance Standards Board, for the development of an appropriate audit regime that will provide an independent opinion on the integrated report. Further, AICD raised a number of issues that it believes need to be considered in the development of an assurance model for integrated reporting.

The IIRC received a total of 63 responses and will publish a summary later this year.

Continuous disclosure

The ASX updated its continuous disclosure guidance (Listing Rules Guidance Note 8 *Continuous Disclosure: Listing Rules 3.1 – 3.1B*) in July 2015. The changes are intended to provide greater clarity on issues related to analyst and investor briefings, analyst forecasts, consensus estimates and earnings surprises; the changes sprung from concerns that some listed entities had misinterpreted the 2013 update to the guidance note relating to earnings surprises and provides

[25] Integrated Reporting, Auditing and Assurance Standards Board, September 2014: http://www.auasb.gov.au/News/Publications/eNewsletter/IssueSep14-Integrated-Reporting.aspx

[26] Submission to IASB on Exposure Draft, Effective Date of IFRS 15, AICD Policy Department, June 23, 2015: http://www.companydirectors.com.au/director-resource-centre/policy-on-director-issues/policy-submissions/2014/assurance-on-integrated-reporting

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further guidance on when an earnings surprise ought to be disclosed to the market. They also seek to address a number of issues related to analyst and investor briefings and the publication of analyst forecasts and consensus estimates.

Updated ASX Listing Rules Guidance Note 27: Trading Policies

In January 2015, ASX released an updated version of Listing Rules Guidance Note 27 *Trading Policies* to help listed entities comply with their obligations; this addresses the following:

- why listed entities are expected to have a trading policy
- who should be restricted from trading in a listed entity's securities
- when trading in a listed entity's securities should be restricted
- what types of trading should be restricted
- exceptions where trading may be permitted
- the procedures a listed entity should have to grant clearances to trade.

The updated guidance incorporates learnings from market developments since the last update in January 2012, most notably ASIC's investigation in late 2013 into trades conducted by two directors of David Jones Limited in the company's shares shortly before the announcement of favourable sales figures. While ASIC cleared the two of any wrongdoing, the incident received considerable criticism in the media and among the company's shareholders.

In light of this, the updated guidance makes it clear that the purpose of a share trading policy is not only to minimise the risk of actual insider trading, but also to avoid the appearance of insider trading and the reputational damage that may cause.

Revised Auditor Reporting Standards

The International Auditing and Assurance Standards Board (IAASB) has released its suite of new and revised Auditor Reporting standards, which contain significant reforms to the layout and wording of auditor's reports. Auditors will be required to include a section that details the 'key audit matters' in the audit report. This term has been defined in ISA 701, Communicating Key Audit Matters in the Independent Auditor's Report as "those matters that, in the auditors judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance".

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The objective was to make these reports more useful by ensuring they communicate clearly with stakeholders, are more informative and provide more relevant information. The changes followed 18 months of extensive international research and public and stakeholder consultation. The standards will be effective for audits of financial statements for periods ending on or after December 15, 2016.

In Australia, these changes will apply to the audit reports of listed entities and in those circumstances that the auditor decides to communicate key audit matters in the auditor's report. These changes will also apply in those instances that auditor is required to communicate key audit matters in their auditor report by law or regulation.

Class actions in Australia

Class actions are an established and important part of the Australian legal landscape. In recent years,

Australia has become the most likely jurisdiction outside of the United States in which a corporation will face significant class action litigation.

Jenny Campbell and Mark Hare, partners at Allens Linklaters, have identified the following trends:[27]

A steady increase in major claims but no 'explosion'

There has been a material increase in the number of class actions filed in recent years compared with the early-to mid-2000s. Somewhat surprisingly, current filings do not match the number of claims filed in the late 1990s.

A broader range of claims

Class actions are now being commenced in a wider range of contexts, when previously they were mainly limited to the product liability arena. By 2009, shareholder class actions had overtaken product liability claims, with shareholder and other investor claims now accounting for roughly 45 per cent of claims filed. The biggest change has been the emergence of natural disaster, mainly bushfire, class actions. Also of note is the increasing use of class actions in the 'public interest' context, such as racial discrimination, false imprisonment, abuse and immigration claims.

A broader range of defendants

In recent years there has been a growing trend toward casting a wider net and away from simply bringing claims against the company most directly connected with the alleged damage. There is now a prevalence of claims against others alleged to have been involved in the loss, such as advisors, auditors, brokers and ratings agencies.

[27] Class action publications, Allens Linklaters, various dates: http://www.allens.com.au/services/ldr/classpubs.htm

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A broader range of plaintiff firms

There is a common perception that a small number of specialist plaintiff firms are responsible for bringing most class actions but, particularly in recent years, many other firms have entered the class actions market.

Most class actions are settled

As the risks associated with a class action judgment and inevitable appeals are high for both the class and defendants, there is a clear trend toward settling the case.

Litigation funding in Australia

Litigants in Australia can obtain funding to pursue legal actions from litigation funders. Litigation funders provide "funds in exchange for a share of the amount recovered and typically agree to pay any adverse costs ordered in the event of a loss."[28] As the Productivity Commission points out, "the Australian market for litigation funding is small but well established — having operated for two decades. Funded cases typically relate to insolvency, large commercial claims and class actions."[29]

In recent years, the approach taken to the regulation of litigation funding in Australia has been one that provides little or no regulation for litigation funders. Under the Corporations Act litigation funders are only required to have a conflicts of interest regime in place. In large part this approach has sought to be supported by access to justice arguments.

The Australian Institute of Company Directors has consistently advocated that litigation funders should be regulated by a tailored licensing regime set out in the Corporations Act.[30]

Such a regime should, among other things, prescribe common safeguards for people entering funding agreements and require litigation funders (including foreign based funders) to meet certain prudential requirements so they have sufficient assets in the jurisdiction to meet any cost orders made against them by a court.

In December 2014 the Productivity Commission recommended that the Australian Government should establish a licence for third party litigation funding companies to verify their capital adequacy and properly inform clients.[31] The Government has not indicated whether it plans to adopt the Productivity Commission's recommendation on this issue.

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[28] Productivity Commission Inquiry Report *Access to Justice Arrangements* September 2014 (released on 3 December 2014) at 22.

[29] Productivity Commission Inquiry Report *Access to Justice Arrangements* September 2014 (released on 3 December 2014) at 22.

[30] See for example the AICD's submissions to Federal Treasury dated 17 August 2011 and 27 January 2012, and to the Productivity Commission dated 4 November 2013 and 19 May 2014 available at www.companydirectors.com.au

[31] Recommendation 18.2, Productivity Commission Inquiry Report *Access to Justice Arrangements* September 2014 (released on 3 December 2014) at 61

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IFRS 15 Revenue from Contracts with Customers

On 23 December 2014, the Australian Accounting Standards Board (AASB) announced that it has approved a new standard, AASB 15 *Revenue from Contracts with Customers*.[32] This standard addresses the recognition and measurement of revenue from contracts with customers in the financial report of an entity.

The Australian Government website reports that the new standard establishes principles, and includes disclosure requirements, for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, based on the international financial reporting standard IFRS 15 *Revenue from Contracts with Customers*.

IFRS 15 addressed concerns by users of financial statements that existing revenue standards have led to inconsistencies between entities' reported revenues, principally in relation to when an entity recognises revenue under some long term contracts – for example, some construction contracts, and contracts that bundle together goods and services such as a telephone handset and network services.

The costs incurred to comply with the new standard are expected to be primarily one-off implementation costs and, to a lesser extent, some ongoing preparation costs for some industries, with the most significant costs for entities that operate in the software and telecommunications services industries.

The proposal has been assessed as likely to have a measurable but contained impact on the economy with no impacts on competition.

A Regulation Impact Statement (RIS) was prepared and certified by the AASB, and has been assessed as compliant by the Office of Best Practice Regulation (OBPR).[33] In addition, the OBPR advises that the process followed by the AASB and the level of analysis contained in the RIS was consistent with best practice. The RIS estimates the average annual regulatory cost at $15.1 million per annum, and identifies offsets. The OBPR has agreed to the regulatory cost and offset estimates.

On 22 July 2015, the IASB after public consultation confirmed the deferral of the effective date of IFRS 15 to 1 January 2018. The IASB also released some proposed clarifications to the Standard for comment to assist companies with implantation.

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[32] *Revenue from Contracts with Customers*, AASB, December 2014: https://www.comlaw.gov.au/Details/F2015L00115/Explanatory%20Statement/Text

[33] Regulation Impact Statement (RIS): http://ris.dpmc.gov.au/2015/01/23/revised-accounting-standard-for-revenue-from-contracts-with-customers-regulation-impact-statement-australian-accounting-standards-board/

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The Australian Competition and Consumer Commission

The Australian Competition and Consumer Commission (ACCC) has renewed its campaign for tougher penalties for companies that break the law and has identified targets for 2015 as detecting and deterring cartels cartel conduct, product safety and truth in advertising.

Cartels

Cartel conduct can occur anywhere across the economy and take several forms:

- Price fixing – when competitors agree on a pricing structure rather than competing against each other.
- Sharing markets – where competitors agree to divide a market so that participants are sheltered from competition.
- Rigging bids – when suppliers agree among themselves before lodging their bids who will win and at what price.
- Controlling the output or limiting the amount of goods and services available to buyers.

The ACCC has around a dozen in-depth cartel investigations under way. The regulator is yet to prosecute a criminal cartel case but holds the view that criminal sanctions for executives found guilty of engaging in hard-core cartel conduct are appropriate. Individuals found guilty of cartel conduct face up to ten years in jail and/or fines of up to $340,000 per criminal cartel offence.

In a civil case, the court can order penalties of up to $500,000 per contravention. Injunctions, orders disqualifying a person from managing corporations and community service orders also apply.

Government procurement

As well as a general focus on detecting and deterring cartels, this year the competition watchdog will also be raising awareness about cartels with procurement officers and agencies, anti-corruption bodies and police.

The ACCC believes cartels have long found public sector purchasing an attractive target due to the large budgets and unique processes.

Announcing the ACCC's priorities at a Committee for Economic Development of Australia (CEDA) event in February, ACCC Chairman Rod Sims said: "We plan to help government procurement officers to identify the signs of cartel conduct. We believe this approach will reduce the vulnerability of procurement processes and generate information which can be further investigated. Ultimately, as taxpayers, we all pay the price if the public tender process is undermined."[34]

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[34] Rod Sims, ACCC chairman, CEDA speech transcript, February 19, 2015: https://www.accc.gov.au/speech/priorities-2015

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Case study: Fortescue

In April 2015, the ACCC concluded a review of public comments made by Andrew Forrest, chairman of Fortescue Metals Group Ltd (Fortescue), calling for a cap on iron ore production.

The review was triggered by concerns that the comments could have been interpreted as an attempt by Forrest to induce Fortescue's competitors to agree to cap iron ore production in contravention of the cartel conduct provisions of the *Competition and Consumer Act 2010*.

Having reviewed the context and circumstances, the ACCC decided not to take any further action. In a media statement, ACCC chairman Rod Sims said: "In deciding not to take further action on the comments that have been made, the ACCC has taken into account Fortescue's position that Mr Forrest's comments were made 'off-the-cuff' in response to audience questions, were hypothetical and intended to encourage a policy debate about the long term future of the iron ore industry.[35] However, it is important that the business community understands that public statements calling for competitors to agree to limit production or to raise prices may constitute a serious cartel offence."

Product safety

As the national agency responsible for the safety of consumer goods, the ACCC is concerned that inadequate quality assurance processes may be causing injuries to consumers.

The Australian Consumer Law contains a number of provisions that place the onus on businesses to supply safe goods. These provisions relate to:

- defective goods and product liability regimes
- the responsibility to report the recall of unsafe goods
- a requirement to report injuries and death associated with consumer products.

Suppliers must have processes in place to ensure that all of the consumer goods they supply are safe. There are also particular requirements, or prohibitions, on a range of products, and businesses may be making false or misleading representations if they continue to supply goods after becoming aware of safety concerns.

The ACCC recognises that the marketplace is competitive and that there are benefits associated with sourcing goods from countries with lower production costs. However, cheaper products should never come at the expense of consumer safety.

[35] 'ACCC concludes assessment of Fortescue chairman's call for cap on iron ore production' press release, ACCC, April 30, 2015: https://www.accc.gov.au/media-release/accc-concludes-assessment-of-fortescue-chairman%E2%80%99s-call-for-cap-on-iron-ore-production

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Selling unsafe goods could expose firms to the costs of recalls, reputational damage and possibly legal action; the regulator also argues that it makes sense for executives and boards to pay close attention to stewardship and supply chain integrity. For everyone in the supply chain, product safety is a shared responsibility.

Case study: cots

In October 2014, Toys 'R' Us Australia Pty Ltd paid a $10,200 infringement notice and provided court enforceable undertakings after supplying 'Nantucket 4-in-1' household cots.

Toys 'R' Us operates more than 30 Toys 'R' Us and Babies 'R' Us stores throughout Australia, as well as an online Toys 'R' Us store. It sold the Nantucket cots online and in its stores between February and November 2013. Testing obtained by the ACCC identified that the cots did not comply with the mandatory safety standard and that they posed a risk of injury or death to infants from falls, entrapment or suffocation. Following the testing, the company cooperated and recalled the Nantucket cots.

The ACCC said: "Companies must have quality assurance systems that can ensure the integrity of their supply chain and that important product safety standards are complied with. Adopting and maintaining a comprehensive compliance program is a fundamental aspect of any retailer's ability to comply with safety standards."[36]

Truth in advertising

Under the Australian Consumer Law, it is illegal for a business to engage in conduct that misleads or deceives, or is likely to mislead or deceive, consumers or other businesses. It is also unlawful for a business to make false or misleading claims about goods or services.

In Rod Sims speech outlining ACCC priorities for 2015,[37] he named truth in advertising as a compliance and enforcement priority for 2015 with a particular focus on misleading claims made by large businesses with the potential for extensive detrimental impact, or where the conduct is likely to become widespread if the regulator does not intervene.

The ACCC believes that truth in advertising is fundamental to the proper functioning of a market economy; when advertising is untruthful consumers are misled, and honest traders are put at a competitive disadvantage.

[36] 'Toys R Us pays penalty for supplying unsafe household cots' press release, ACCC, October 20, 2015: https://www.accc.gov.au/media-release/toys-r-us-pays-penalty-for-supplying-unsafe-household-cots

[37] Ibid 29

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At the National Consumer Congress in March, ACCC Chairman Rod Sims said: "We believe truth in advertising is fundamental to the proper functioning of a market economy. Our action in this area serves a dual purpose. When advertising is untruthful consumers are misled, and honest traders are put at a competitive disadvantage. There can then be a downward spiral."[38]

Case study: free range eggs

In September 2014, the Federal Court declared by consent that Pirovic Enterprises Pty Ltd (Pirovic) engaged in misleading conduct and made misleading representations in its labelling and promotion of eggs as 'free range'.

Pirovic is one of the largest independent egg producers in New South Wales and supplied eggs labelled as 'cage', 'barn laid', 'free range' and 'organic free range' and a variety of liquid egg products to retailers nationally. From January 2012 until January 2014, Pirovic used egg cartons which included the words 'Free Range' and images of hens on open pasture.

The Court found that the eggs supplied by Pirovic were produced by hens that did not move about on an open range due to a combination of the following factors:

- the stocking densities inside the barns where the hens were housed
- the flock sizes inside those barns
- the number, size and placement and operation of the physical openings to the open range.

The Court ordered that Pirovic pay a pecuniary penalty of $300,000 and contribute to the ACCC's costs. ACCC Chairman Rod Sims said: "Credence claims such as free range claims are powerful tools for businesses to distinguish their products. However, if they are false or misleading, they serve to mislead consumers, who may pay a premium to purchase such products. This decision provides very clear guidance that any free range egg claim must be backed by farming conditions and practices implemented by suppliers under which hens actually move about on an open range each day."[39]

Case study: Coles par baked bread products

In April 2015, the Federal Court ordered Coles Supermarkets Australia Pty Ltd to pay penalties of $2.5 million for making false or misleading representations and engaging in misleading conduct in relation to the promotion of its par baked bread products.

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[38] 'Preparing consumers for the future, today: The upcoming review of the Australian Consumer Law', 2015 National Consumer Congress, ACCC, March 20, 2015: https://www.accc.gov.au/system/files/Consumer%20Congress%202015%20-%20Program.pdf

[39] 'Federal Court orders $300,000 penalty after finding "free range" egg claim to be misleading' press release, ACCC, September 23, 2014: https://www.accc.gov.au/media-release/federal-court-orders-300000-penalty-after-finding-free-range-egg-claims-to-be-misleading

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The products were promoted as ‘Baked Today, Sold Today’ and in some cases ‘Freshly Baked In-Store’, when they were, in fact, partially baked and frozen off site by a supplier, transported and ‘finished’ at in-store bakeries within Coles supermarkets.

In handing down the earlier judgment in June 2014, Chief Justice Allsop said: “Advertising should not be parsed and analysed in the fashion of a 19th Century equity draftsperson. Nevertheless, the courts should be astute and careful not to permit consumers to be misled on available meanings or connotations of phrases deliberately chosen to sell products on the basis that everyone takes advertising with a pinch of salt. To place emphasis on advertising licence that bends the truth will not only degrade the language, but lead to a culture of deception in the market.”

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6. Government Reviews

APRA's response to the Financial System Inquiry

The Financial System Inquiry was instigated with the intention of establishing a direction for the future of Australia's financial system. The Inquiry promised a blueprint for the financial system over the next decade. The final Report was released in December last year and makes 44 recommendations. Of particular relevance to directors, these recommendations included:

- Introducing new governance requirements for public offer superannuation funds, including that there be a majority of independent directors on the boards corporate trustees including an independent chair; aligning the director penalty regime with managed investment schemes; and strengthening the conflict of interest requirements
- Providing regulators (including ASIC and APRA) with more stable funding by adopting a three-year funding model based on periodic funding reviews, increase their capacity to pay competitive remuneration, boost flexibility in respect of staffing and funding, and require them to undertake periodic capability reviews
- Providing ASIC with stronger regulatory tools and an industry funding model for ASIC be introduced
- Consulting on possible amendments to the external administration regime to provide additional flexibility for businesses in financial difficulty.

The Government is consulting on the Inquiry's recommendations before it makes any decisions on the recommendations and AICD made a submission in response to some of the Inquiry's recommendations in March 2015.[40]

Many of the recommendations relate to areas that are the responsibility of financial regulators, including ASIC and APRA and will need to be considered separately by those regulators. However, in January, the Australian Financial Review reported that APRA does not intend to begin formal consultations on whether changes to Australian bank capital levels are warranted until the Basel Committee on Banking Supervision has completed its own consultations on a fundamental rethink to the way all global banks determine the 'risk weights' that are applied to their loans.

[40] http://www.companydirectors.com.au/~/media/resources/director%20resource%20centre/policy%20on%20director%20issues/2015/subm_2015_treasury%20-%20financial%20services%20inquiry%20final%20report_f.ashx

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These risk weights inform how much equity is needed to meet the capital ratios required by global banking regulators. Higher capital ratios limit the level of bank leverage and hence reduce the risk that creditors, depositors or taxpayers will be forced to contribute towards the costs of a banking collapse.

The Basel Committee said its work would be completed by the end of 2015.

The Harper Review

The final report of the Competition Policy Review, known as the Harper Review, was released in March this year. The panel reported evidence that microeconomic reform is critical to increased productivity and that reinvigorating Australia's competition landscape is a central element. Their review of whether Australia's existing competition policy, laws and institutions remain fit for purpose was the most significant of its kind in over 20 years.

In the panel's view, competition policy should:

- make markets work in the long-term interests of consumers
- foster diversity, choice and responsiveness in government services
- encourage innovation, entrepreneurship and the entry of new players
- promote efficient investment in and use of infrastructure and natural resources
- establish competition laws and regulations that are clear, predictable and reliable
- secure necessary standards of access and equity.

The ACCC welcomed the many pro-competitive reforms and particularly the report's findings on roads, shipping, intellectual property and parallel imports. It also supports proposals to make the misuse of market power provision workable,[41] to introduce a prohibition on concerted practices and to improve merger assessment processes. It also commends the panel's recommendations to make the Act easier for businesses to understand. However, chairman Rod Sims expressed concern that changes to the law might weaken Australia's cartel laws. He also said that the fine detail of some of the proposed changes will require further consideration.[42]

[41] On 17 November 2014, AICD provided a submission to the Competition Policy Review raising concerns about the proposed policy changes to section 46 of the Competition and Consumer Act relating to the misuse of market power by corporations. AICD's submission stated that the proposed policy changes to section 46 would likely result in greater uncertainties for companies seeking to comply with the provision and would adversely impact on innovation and efficient outcomes, pro-competitive conduct and the long-term interests of consumers. AICD's submission is available at www.companydirectors.com.au.

[42] 'ACCC welcomes pro-competitive recommendations of Harper review' press release, March 31, 2015: https://www.accc.gov.au/media-release/accc-welcomes-pro-competitive-recommendations-of-harper-review

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Productivity Commission's discussion paper *Business Set-Up, Transfer and Closure*

In 2014, the Government requested that the Productivity Commission consider, amongst other things, regulations affecting the ease of starting, operationalising or closing a business and the personal/corporate insolvency regimes on business exits.[43] In response, the Productivity Commission commenced an inquiry into *Business Set-Up, Transfer & Closure. An issues paper was released in December 2014 and after receiving submissions, a draft report was released in May 2015.*

The Productivity Commission's draft report made a number of recommendations, including that a safe harbour be introduced to allow companies and directors to restructure without liability for insolvent trading[44] and that restrictions be imposed on the enforceability of *ipso facto* clauses upon an insolvency event.[45]

AICD made submissions in response to both the issues paper[46] and the draft report[47], confining its comments to aspects of Australia's corporate insolvency regime.

In summary, the AICD's comments were as follows:

- AICD is of the view that the primary objective of Australia's insolvency regime should be corporate recovery. The insolvency regime should encourage entrepreneurialism and operate to save businesses that can be saved. This would encourage innovation, economic growth and the preservation of employment.
- Australia's insolvency regime must also protect relevant corporate stakeholders including employees, suppliers, customers, creditors and shareholders. However, AICD is concerned that aspects of the current regime sometimes prevent the best stakeholder outcomes from being achieved.
- The liability of directors for insolvent trading needs to be addressed as it effectively mandates directors to move to external administration as soon as a company encounters financial difficulties, in order to avoid personal liability and consequent reputational damage.
- While AICD remains of the view that the introduction of the proposed Honest and Reasonable Director Defence is preferable, an appropriately formulated safe harbour provision for insolvent trading would be an improvement to the current position at law and may improve the ability of directors to attempt a restructure.
- AICD supports the proposal that *ipso facto* clauses allowing contracts to be terminated due to an insolvency event be unenforceable on the appointment

[43] See Productivity Commission *Business Set Up, Transfer & Closure Inquiry* at http://www.pc.gov.au/inquiries/current/business

[44] Recommendation 15.2, Productivity Commission Draft Report *Business Set-Up, Transfer & Closure* May 2015

[45] Recommendation 15.4, Productivity Commission Draft Report *Business Set-Up, Transfer & Closure* May 2015

[46] See the AICD submission to the Productivity Commission Business *Set-Up, Transfer & Closure Inquiry* dated 17 February 2015, available at www.companydirectors.com.au

[47] See the AICD submission to the Productivity Commission *Business Set-Up, Transfer & Closure Inquiry* dated 3 July 2015, available at www.companydirectors.com.au

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of an administrator or a receiver or when the company is in the safe harbour. However, some limited exceptions to this restriction could be considered.

In its draft report the Productivity Commission also proposed that company directors be allocated a 'director identity number' (DIN).

Under this proposal, a director would have only one DIN regardless of how many directorships he or she holds. The purpose of this proposal is to assist with the enforcement of laws relating to phoenix activity by providing a means to identify directors (rather than relying on name and address information that appears on the ASIC register, which may be unverified) and to prevent the use of fictitious identities.

Current directors would be required to apply to ASIC for a DIN and then provide the DIN at the annual review date for the company as a change to the company details. For new directors, a DIN would be allocated to an individual at the time of his or her first directorship. In order to obtain a DIN, an individual would be required to provide 100 points of identification proof, and also verify that he or she has read materials on director's legal responsibilities that would be provided as part of the director registration process.

In respect of the proposal to introduce a DIN regime, AICD noted that it supports effective efforts to reduce fraudulent phoenix activity, but queried whether the resources necessary to introduce and supervise the DIN regime could be better utilised by ASIC to enforce existing laws targeted at phoenix activity.[48]

The final report of the Productivity Commission is expected to be provided to the Government in September 2015.

[48] See the AICD submission to the Productivity Commission in response to the *Business Set-Up, Transfer & Closure Inquiry* dated 3 July 2015 available at www.companydirectors.com.au

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