Australian Institute *of* **Company Directors**

Essential Director Update 2019 Handbook

Navigating the new governance environment.

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Welcome

The Essential Director Update is one of the Australian Institute of Company Directors' most valued member services. Our largest event series, it is a core member benefit designed to provide you with valuable insights and the latest developments in the governance, business and regulatory landscapes that impact director duties and responsibilities.

2019 has seen a shift in the breadth and depth of the governance landscape, through increased expectations on the accountability of boards and new developments impacting the responsibilities and liabilities facing the director community.

Such a dynamic backdrop carries a host of governance issues to be considered and this year's event theme is "Navigating the New Governance Environment". Following last year's successful format, Graham Bradley AM FAICD will present the event in capital cities and our team of experienced directors and respected past contributors – Marion Macleod FAICD, David Shortland MAICD and Sarah Cobb GAICD – will deliver the event series in other metropolitan and regional cities.

The *Essential Director Update 2019 Handbook* is designed to augment your event experience. It builds on the topics covered in the event series with expert articles across a wide range of contemporary governance, business and regulatory topics.

I hope you enjoy the 2019 Essential Director Update and find it both informative and thought-provoking in its coverage, with insights you can apply in your governance practices.

Angus Armour FAICD
Managing Director and Chief Executive Officer,
Australian Institute of Company Directors

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1. The Governance Environment

Boards are dedicating greater attention to assessing culture and governance, stakeholders with whom to engage, and any independent, external support that may be required.

1.1 Evolving Governance

1.1.1 Complex challenges and changing expectations

Louise Petschler GAICD
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Australian directors are operating in a complex environment, with increasing expectations on the role and accountability of boards.

While many of these factors are particularly acute for boards of larger listed entities and those in financial services, they are relevant to directors in entities from all sectors and sizes:

- changing community expectations of the board's role;
- accountability for corporate wrongdoing
- increasing focus on the governance of culture
- complex, conflicting stakeholder impacts and expectations
- personal reputational risks
- increased D&O premiums and exclusions
- enforcement focus by regulators (for example, ASIC's 'why not litigate' model, governance focus)
- higher penalties for breaches of duties and new layers of law

These factors link to broader debate about the role of corporations in society, reflected in the recent US Business Roundtable statement[1] where CEOs of some of the largest companies in the US, in a forum that was previously a staunch advocate of shareholder primacy as the basis for the US corporate model, issued a new statement on the purpose of the corporation.

The US Business Roundtable now says that customer value, investing in employees, fair and ethical supplier relationships and care for the community and environment are also the purpose and responsibility of business – in addition to long-term shareholder value.

While there are important differences between US and Australian corporate governance and law – notably, for example, the duty of Australian directors to act in the best interests of the company – these US business leaders are responding to a broader global challenge to the role and purpose of business.

Changing community expectations were also highlighted in an Australian context in the Committee for Economic Development of Australia's (CEDA) *2019 Company pulse* report[2], released in September 2019.

CEDA's study found that the community expects a broad contribution from business, including on social and environmental issues. Both business leaders and the community broadly agree that the public now has higher ethical standards for large companies, but less than half of the general public believe that the ethical behaviour of large companies has improved.

According to the research, 72 per cent of those surveyed believe business should place equal importance on economic, environmental and social performance measures, and 78 per cent support business leaders speaking out on issues of national importance.

[1] Business Roundtable, 2019, *Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'*, 19 August, Washington, https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans, (accessed 18 September 2019).

[2] Committee for Economic Development of Australia, 2019, *Company pulse 2019*, September, https://www.ceda.com.au/CEDA/media/General/Publication/PDFs/CompanyPulseFinal_16SepUpdate.pdf, (accessed 18 September 2019).

Some of the challenges and the debate on directors' duties and stakeholder considerations were captured in the AICD's Forward Governance Agenda[3], where the AICD affirmed its support for the current framing of the Australian best interests duty but recognised the increasing expectation for directors to more clearly demonstrate genuine engagement with stakeholder impacts and issues.

Changing expectations about the purpose of the corporation will continue to challenge companies, governments, investors/members and stakeholders.

There will be new conversations in boardrooms: on issues from organisations taking a public stance on broader national social or policy issues, on stakeholder expectations, and on new layers of regulation seeking to respond to community sentiment.

There is considerable risk of regulatory overreach in this environment, where a more prescriptive approach may be attractive to policy makers.

Of course, directors must be held accountable for breaches of their governance duties and we must have firm laws and penalties, robustly enforced by well-resourced regulators.

But it is also critical that the role of the board is appropriately reflected in the law and expectations of directors. And directors, acting with due care and diligence, must have confidence that the law respects their important obligations as well as providing fair defences.

Directors face some new and complex issues in the current landscape, as this *Essential Director Update 2019 Handbook* demonstrates in its range of topics and updates.

From engaging on these important new debates, advancing sound policy positions and supporting new guidance and research and engagement with stakeholders, directors and the AICD will be well-served by bringing an open and proactive mindset to this complex environment.

1.1.2 AICD Forward Governance Agenda

Extracted from 15 August 2019
"What's next for the AICD's Forward Governance Agenda actions?"
The Boardroom Report, Volume 17, Issue 8, AICD

Over 1,200 members responded to the AICD Forward Governance Agenda consultation paper released in April 2019.[4] This consultation sought member views on areas where the AICD should increase its focus or change its approach to strengthen governance practice. It has helped guide the AICD's priorities for building the capability of Australian directors, and the positive impact this will have on how boards govern their organisations and restore trust from their communities.

One of the major findings was that there was strong support (85 per cent) among members for a review of the Code of Conduct to focus on clear standards of conduct and practice expected of directors. In addition, 75 per cent supported ethical decision making in governance practice and 58 per cent backed the idea of introducing a fit-and-proper person test for members.

[3] AICD, 2019, *Forward Governance Agenda – Consultation Results and Next Steps*, https://aicd.companydirectors.com.au/advocacy/the-forward-governance-agenda, (accessed 18 September 2019).
[4] AICD, 2019, *Forward Governance Agenda: Lifting Standards and Practice*, April, http://aicd.companydirectors.com.au/-/media/cd2/resources/advocacy/forward-agenda/pdf/aicdforwardagenda-final.ashx, (accessed 16 September 2019).

Key consultation findings:[5]

Standards and professionalism

- Members support a revised AICD member code of conduct with a focus on clear standards of practice and strengthened director professional development (DPD) obligations.

Duties and stakeholders

- Members expect the AICD to lead the debate on director duties.

Demonstrating accountability

- Members are concerned about director and board accountability and want guidance around good practice.

Culture and remuneration

- Culture is a high priority for directors. Members want practical support around the governance of culture and remuneration.

To date, the AICD has released two new guides relating to the Forward Governance Agenda themes: a director tool on governing organisational culture[6], and practical guidance on good practice board minutes[7].

Over the coming months, the AICD will continue working on targeted initiatives under each of the Forward Governance Agenda key themes:

Standards and professionalism

- Commence a formal review of the AICD code of conduct, to include consideration of standards of governance practice and options for compliance frameworks;
- Revise the AICD's DPD scheme to require a focus on priority topic(s) as part of each 3-year DPD cycle.

Duties and stakeholders

- Refresh AICD resources on director duties to reflect contemporary practice, within the current framing of the best interests duty;
- Support debate with greater stakeholder engagement and new research;
- Deliver new guidance on bringing stakeholder voices to the board;
- Increase the prominence of stakeholder views in AICD communications.

Demonstrating accountability

- Increase the focus on stakeholder and community understanding of the role of the board and non-executive directors;
- Consider non-prescriptive guidance on board commitments;
- Further research annual director election models and impacts.

Culture and remuneration

- Develop new resources to support members in the governance of culture;
- Engage proactively on expectations on the governance of remuneration, promoting appropriate framing of the board's role with stakeholders;
- Consider scope for good practice guidance on the governance of remuneration.

[5] AICD, 2019, *Forward Governance Agenda: Results of Member Consultation*, August, http://aicd.companydirectors.com.au/-/media/cd2/resources/advocacy/forward-agenda/pdf/07194-2-1-adv-forward-agenda-finding-report-2019-a4-20pp-v8.ashx

[6] Refer to the AICD Director Tool *Governing organisational culture*, https://aicd.companydirectors.com.au/resources/director-tools/practical-tools-for-directors/governing-organisational-culture, (Accessed 16 September 2019).

[7] Refer to the Australian Institute of Company Directors and Governance Institute of Australia, 2019, *Joint statement on board minutes*, plus related webcast, https://aicd.companydirectors.com.au/advocacy/research/minutes-statement, (accessed 16 September 2019).

1.1.3 Financial Services Royal Commission

Christian Gergis GAICD
Head of Policy
Australian Institute of Company Directors

Commissioner Hayne's final report[8] was released publicly on 4 February 2019, along with the government's response to the inquiry's recommendations.

The report highlighted that "failings of organisational culture, governance arrangements and remunerations systems, lie at the heart of much of the misconduct examined in the Commission".[9] According to Hayne, improvements in each of these areas should reduce the risk of misconduct in future, and improvements in one area will reinforce improvements in others.

He stressed that "the primary responsibility for misconduct in the financial services industry lies with the entities concerned and with those who manage and control them: their boards and senior management".[10]

While not allowing entities to shirk the responsibility to drive change, Hayne emphasised that the regulators also have an important role to play in the supervision of culture, governance and remuneration. Supervision of non-financial risks is key to this.

The report also reinforces fundamental tenets of governance by making it clear that boards and their gatekeeper committees must:

- sufficiently challenge management;
- do all they can to satisfy themselves that they are receiving the right information and inputs from management to make complex decisions;
- monitor, measure and assess corporate culture and governance; and
- provide rigorous oversight of risk, including non-financial risks.

In the context of ongoing debate, Hayne also made the point that directors must discharge their duties in good faith in the best interests of the corporation and for a proper purpose. Hayne made clear that it is the corporation that is the focus of directors' duties, and that this demands consideration of more than the financial returns that will be available to shareholders in any particular period. According to Hayne, in the longer term, the interests of all stakeholders associated with the entity converge, and the pursuit of the best interests of the entity does not involve making a binary choice between the interests of shareholders and the interests of customers. The Australian Institute of Company Directors (AICD) shares this view.

In the wake of the final report, boards are dedicating greater attention to assessing culture and governance, including the most appropriate metrics (ideally not confined to lag indicators), stakeholders with whom to engage, and any independent, external support that may be required.

Boards, both inside and outside financial services, are also increasingly focusing on their oversight of remuneration and on better understanding of the impact that frameworks and practices can have on individual behaviour.

[8] K M Hayne, 2019, *Final Report Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Volume 1*, February, Commonwealth of Australia, https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf, (accessed269 August 2019).

[9] Ibid, p 412.

[10] Ibid, p 4.

1.1.4 ASX Corporate Governance Principles and Recommendations, 4th Edition

Christian Gergis GAICD
Head of Policy
Australian Institute of Company Directors

In late February 2019, after an extensive public consultation, the fourth edition of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*[11] (ASX Principles) was released. The new guidelines will apply to listed entities on an 'if not, why not' basis for disclosure for financial years commencing on or after 1 January 2020. The fourth edition addresses issues of culture, values and trust against a backdrop of low levels of trust and community scepticism towards business and governance failings highlighted by the Financial Services Royal Commission.

The 19 members of the ASX Corporate Governance Council, including the AICD, unanimously endorsed the revised ASX Principles after issues raised during consultation were addressed in the final document, including concerns that the principles risked becoming too detailed and prescriptive.

ASX Corporate Governance Council chair Elizabeth Johnstone FAICD said changes in the fourth edition were "evolutionary, not revolutionary".[12] All but one of the recommendations proposed in the consultation draft were included, with the number of recommendations increasing to 35 (although commentary was significantly streamlined).

The concept of 'social licence to operate' — the subject of heated debate during the public consultation process on the draft — did not find its way into the final version of the ASX Principles. Stakeholder feedback revealed a gulf in opinion between those who saw the concept as pivotal to business operating in a broader societal context and others, like the AICD, who believed a subjective term was inappropriate in a quasi-regulatory document. Ultimately, the ASX Corporate Governance Council replaced the 'social licence to operate' references in the commentary with references instead to 'reputation' and 'standing in the community'.

The most significant changes were to Principle 3, now expressed as requiring listed entities to 'instil a culture of acting lawfully, ethically and responsibly'.[13] It is underpinned by new recommendations for entities to articulate and disclose their values, whistleblower and anti-bribery and corruption policies, and the recommendation that a listed entity's board should be informed of any material breaches of the entity's code of conduct. The changes to Principle 3 are reinforced by revisions under Principle 1, which include mandating board charters and more detailed articulation about how management and board responsibilities should be split.

In the wake of the Financial Services Royal Commission, the ASX Principles makes clear the senior executive team will usually be responsible for providing the board with accurate, timely and clear information on not only financial performance but also compliance with material legal/regulatory requirements, and any conduct materially inconsistent with the entity's values or code of conduct.

[11] ASX Corporate Governance Council, 2019, *Corporate Governance Principles and Recommendations*, 4th Edition, February, https://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-fourth-edn.pdf, (accessed 26 August 2019).

[12] S Linwood and C Gergis, 2019, "Changes to the latest ASX Corporate Governance Principles and Recommendations", *Company Director*, 1 April, https://aicd.companydirectors.com.au/membership/company-director-magazine/2019-back-editions/april/update-corp-governance-principles (accessed 26 August 2019).

[13] ASX Corporate Governance Council op cit, p 16.

In the area of environmental and social risks, the commentary to revised recommendation 7.4 now asks "entities that believe they do not have any material exposure to environmental or social risks to consider carefully their basis for that belief and to benchmark their disclosures in this regard against those made their peers".[14] The ASX Principles now also encourages listed entities with material exposure to climate change risk to consider implementing the recommendations of the Financial Stability Board's Task Force on Climate-Related Financial Disclosures, following on from similar guidance from both the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA).

1.1.5 AICD Not-for-Profit Governance and Performance Study, 10th Edition

Phil Butler GAICD
Not-for-Profit Sector Leader
Australian Institute of Company Directors

In July 2019, the AICD published the 10th edition of the *Not-for-Profit Governance and Performance Study.*[15] The study received over 1400 responses to an online survey and staged a series of focus groups across Australia. The publication reports on the following seven key findings on the Australian not-for-profit (NFP) sector, and raises some questions for NFP boards to consider:

1. **NFP directors' time commitment – is it sustainable?**
    - The percentage of directors working more than five days per month on a single NFP board has risen from 13 per cent in 2013, to 23 per cent in 2019.
    - Over 50 per cent of respondents are working more than two days per month on a single NFP board.
    - Board questions to be considered:
        i. Are rising workloads impacting on our board's succession planning?
        ii. Could we utilise technology better to reduce the workload of directors?
2. **Board composition and director recruitment are ongoing challenges**
    - 38 per cent of directors are highly experienced, with 11 years or more of non-executive NFP experience.
    - Only 5 per cent of respondents were under 40 years of age.
    - Board questions to be considered:
        i. Have we struggled to attract younger directors?
        ii. Do we have a strategy for director diversity?
3. **NFP director remuneration – where is it heading?**
    - The percentage of directors being remunerated has not changed greatly over the years of the study.
    - 19 per cent of respondents reported being remunerated in 2019, compared to 15 per cent in 2014.
    - Remuneration is much more common in organisations with turnover of $20 million or more, and in more commercial style organisations.

[14] Ibid, p 28.
[15] Australian Institute of Company Directors, 2019, *Not-for-Profit Governance and Performance Study*, July, https://aicd.companydirectors.com.au/-/media/cd2/resources/advocacy/research/2019/pdf/07277-adv-nfp-governance-performance-study-2019-a4-68pp-web-2.ashx, (accessed 26 August 2019).

- Board questions to be considered:
  - i. Have we had the conversation around director remuneration?
  - ii. What would our stakeholders think of a move to remuneration?

4. NFPs are effective but remain financially challenged

- Most directors believe their organisation is effective, with 91 per cent stating that their organisation is effective in achieving its purpose.
- There is also more confidence in the performance measures being used today compared to five years ago.
- Financial challenges persist with some inconsistency between profit expectations and actual profit. While many expected their NFP organisation to be financially strong, over 45 per cent reflected on either making a loss or barely breaking even over the previous three years.
- Board questions to be considered:
  - i. How confident are we in our (non-financial) performance measures?
  - ii. Are there financial challenges ahead for our organisation?

5. NFP mergers are slowing – will this continue?

- The rate of mergers appears to be slowing with only five per cent undertaking a merger, compared to eight per cent three years ago.
- Similarly, discussions on mergers had also dropped significantly with only 30 per cent of respondents having discussed a merger, compared to 38 per cent two years ago.
- There are low rates of merger expectations in the near future.
- Board questions to be considered:
  - i. How would our stakeholders view a merger?
  - ii. Do we have the appropriate skills and experience for a merger?

6. Board performance is rated highly but an increased focus on strategy is a priority

- Directors are generally satisfied with the performance of their board and the quality of governance. However, it was noteworthy that 28 per cent said it was poorer than it should be.
- The key priority area that was noted was around strategy. Respondents reflected that an improvement in strategic planning and the monitoring of the implementation of strategy should be a focus over the next year
- Board questions to be considered:
  - i. Is the quality of our governance appropriate?
  - ii. Is strategic planning an area that requires greater focus?

7. Challenges facing sporting organisations have evolved

- Key challenges for sports organisations are growth in revenue and membership, and facility improvements
- Other areas for consideration that were raised included sports gambling, digital technology and social media (particularly in focus groups)
- Transitioning from federated structures to single national structures continue to cause some challenges
- Board questions to be considered:
  i. Do we have a clear strategy, and the appropriate infrastructure, to grow our organisation and our sport?
  ii. Do we understand our key risks?

1.1.6 AICD Not-for-Profit Governance Principles, 2nd Edition

Sally Linwood
Senior Policy Advisor
Australian Institute of Company Directors

In January 2019, the AICD published a new edition of *Not-for-Profit Governance Principles* (the NFP Principles).[16]

The first edition of the NFP Principles was published in 2013 and aimed to provide a practical resource to support boards and directors of not-for-profit organisations. Since that time, the not-for-profit sector has undergone substantive regulatory reform. The revised principles, which were informed by detailed consultation with the sector, respond to this changed environment and address the higher expectations of good not-for-profit governance.

The NFP Principles provides a detailed, practical and principles-based framework to help not-for-profit organisations achieve good governance. The publication consists of 10 individual principles and supporting practices and guidance on each.

While the new edition includes more detailed descriptions of governance and additional guidance, it recognises there is no 'one size fits all' approach. Indeed, consultation participants observed the importance of understanding and accommodating the diversity of the not-for-profit sector, recognising the variation in the size, resources and maturity of the organisations within in it.

Governance is complex and the sector is diverse. It is a matter for each not-for profit organisation to carefully consider how best to apply the principles to their own circumstances.

The principles are also voluntary in application, although the AICD encourages organisations to consider assessing how their governance practices align with the principles and reporting to stakeholders on a voluntary, 'if not, why not' basis.

[16] Australian Institute of Company Directors, 2019, *Not-for-Profit Governance Principles*, 2nd edition, January, https://aicd.companydirectors.com.au/-/media/cd2/resources/director-resources/not-for-profit-resources/nfp-principles/pdf/06911-4-adv-nfp-governance-principles-report-a4-v11.ashx, (accessed 26 August 2019).

The Not-for-Profit Governance Principles:

1. Purpose and strategy – the organisation has a clear purpose and a strategy, which aligns its activities to its purpose
2. Roles and responsibilities – there is clarity about the roles, responsibilities and relationships of the board
3. Board composition – the board's structure and composition enable it to fulfil its role effectively
4. Board effectiveness – the board is run effectively and its performance is periodically evaluated
5. Risk management – board decision making is informed by an understanding of risk and how it is managed
6. Performance – the organisation uses its resources appropriately and evaluates its performance
7. Accountability and transparency – the board demonstrates accountability by providing information to stakeholders about the organisation and its performance
8. Stakeholder engagement – there is meaningful engagement of stakeholders and their interests are understood and considered by the board
9. Conduct and compliance – the expectations of behaviour for the people involved in the organisation are clear and understood
10. Culture – the board models and works to instil a culture that supports the organisation's purpose and strategy

1.2 Reporting, Disclosures and Risks

1.2.1 Environmental, social and governance reporting trends

Louise Davidson
CEO
Australian Council of Superannuation Investors

Investors are increasingly concerned about environmental, social and governance (ESG) issues and their impact on long-term investment outcomes. In addition, the lack of trust that many businesses are now facing highlights the importance of managing ESG risks and opportunities well.

It is generally accepted that directors should have regard to a broad range of stakeholders when determining what's in the best interests of the company. However, there remain examples of companies relentlessly focusing on profit at the expense of some stakeholders, such as customers and employees. This approach is increasingly recognised as unsustainable.

In the final report of the Financial Services Royal Commission, Commissioner Hayne examined the nature of the director's duty, noting: "The longer the period of reference, the more likely it is that the interests of shareholders, customers, employees and all associated with any corporation will be seen as converging on the corporation's continued long-term financial advantage."[17]

What does this mean in practice for directors?

Actively managing ESG risks and opportunities (including considering the views of a broad range of stakeholders) can underpin better financial performance over the long term. While many directors are confident that they already consider a broad range of views, given the current environment it's a good time for all directors to re-examine their approach.

In this respect, it can be useful to consider examples from other jurisdictions. In the UK, for example, the director's duty is framed as a duty to promote the success of the company, having regard to a number of stated matters including:

- the long-term consequences of the decision;
- the company's employees, relationships with suppliers, customers and others;
- the impact on the community and the environment;
- high standards of business conduct; and
- the need to act fairly between members of the company.

While the Australian duty does not set out these matters specifically, they are all examples of ESG matters that are financially material over the long term. Directors should make sure they consider how their organisation approaches these key matters. For example:

- How are stakeholder views are considered across their organisations?
- How do directors themselves gather and consider stakeholder views?

[17] K M Hayne, 2019, *Final Report Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Volume 1*, February, Commonwealth of Australia, p 402, https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf, (accessed 19 August 2019).

- Are there formal and informal mechanisms for doing so?
- Are some of those mechanisms independent from management?

Even though directors may be confident that they take a broad range of stakeholders into account in their decisions, investors and the broader community have very little insight in this respect. Directors should consider how well they communicate their approach, including to affected stakeholders and investors. Again, by way of comparison, directors in the UK are required to describe in the annual report how they have had regard to the matters specified in their duty.

Our view is that improving the management and communication of ESG matters offers significant opportunity to establish credibility and trustworthiness, particularly in the current low-trust environment.

Regulators too have recognised the necessity of good disclosure on ESG matters. For example, both APRA and ASIC have been clear that climate change risks can be financial in nature and should be considered by directors and disclosed appropriately. Australia's new *Modern Slavery Act 2018* (Cth) also requires some organisations to report on the risks of modern slavery in their operations and supply chains.

These are just two examples of a range of issues that can be financially material over the long-term. An updated *ACSI Governance Guidelines* will be released later in 2019 and will provide further guidance for directors on the effective management of ESG risks and opportunities and accompanying disclosure.

1.2.2 Investor expectations and influence

Sally Linwood
Senior Policy Advisor
Australian Institute of Company Directors

The size and influence of industry funds in the economy is growing, with implications for governance in corporate Australia. As at May 2019, industry fund assets totalled $678 billion.

Direct board-level engagement with industry super funds is now the norm, with institutional investors committed to active ownership and boards recognising the imperative to understand and respond to investor expectations not only on strategy but also environmental, social and governance (ESG) issues such as climate change, gender diversity, human rights and the supply chain, and executive remuneration.

Engagement on ESG factors is integral to active ownership, with major institutional investors and the Australian Council of Superannuation Investors (ACSI) continuing to strongly emphasise the clear link between good ESG management and stronger long-term returns for members.

Currently, ACSI's members include 39 Australian and international asset owners and institutional investors. Collectively, ACSI's members manage over $2.2 trillion in assets and own on average 10 per cent of every ASX200 company.

Corporate accountability has been a focus of ACSI in 2019, with the release of a number of policy proposals intended to improve corporate accountability. The proposals include: introducing a binding vote on remuneration policy every three years, disclosing CEO-median worker pay ratios to shareholders, introducing annual director elections and giving shareholders the right to propose non-binding resolutions to company meetings.

ACSI has also made the following proposals intended to strengthen investment stewardship and has called on policy makers and regulators to commit to them:

- That APRA standards and guidelines be revised to explicitly recognise ESG issues in the formulation of investment strategies and require superannuation trustee boards to have access to capacity and competence on ESG issues; and
- That the regulatory framework for stewardship be reviewed, including to consider appropriate minimum standards and reporting, the appropriate regulatory framework, and a stewardship code that applies to all institutional investors.

Notably, ACSI's annual review of ESG reporting by the ASX200 indicated that ESG reporting standards have improved significantly but there continues to be issues with the quality and comparability of ESG reporting. ACSI called out a number of specific matters including inadequate reporting of safety data and limited reporting of long-term emissions reduction targets.

Clearly, addressing material ESG risks (and opportunities) will remain an imperative for all corporate players.

1.2.3 Climate change

Sarah Barker MAICD
Head of Climate Risk Governance
MinterEllison

The last few years have seen increasing mainstream recognition of the evolution of climate change evolve from an 'ethical, non-financial' issue to one that presents material financial risks (and opportunities) for business. In 2019, the need for directors to robustly consider how climate change should be integrated into their assessment and reporting of corporate performance, position and prospects has become unequivocal, for three key reasons.

Firstly, in March 2019, leading commercial barrister Noel Hutley SC issued an update to his seminal opinion of 2016, affirming (and strengthening) his view that climate change is a financial issue to which company directors must apply due care and diligence (s 180 of the *Corporations Act 2001*(Cth)).[18]

Secondly, in August 2019, ASIC published an update to Regulatory Guide 247 *Effective disclosure in an operating and financial review*[19], specifically referring to the June 2017 recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD). The TCFD provides a framework for companies to disclose the material impacts of climate change on their financial performance and prospects, in a form that is decision-useful for investors, lenders and insurance underwriters. Its key recommendation centres on stress testing and scenario planning across the plausible range of climate futures – including a scenario consistent with the Paris Agreement's target to limit global warming to well below 2°C above pre-industrial averages (which would necessitate decarbonisation of the global economy prior to 2050).

[18] N Hutley and S Hartford Davis, 2019, *Climate Change and Directors' Duties: supplementary memorandum of opinion*, 26 March, The Centre for Policy Development, https://cpd.org.au/wp-content/uploads/2019/03/Noel-Hutley-SC-and-Sebastian-Hartford-Davis-Opinion-2019-and-2016_pdf.pdf, (accessed 2 September 2019).

[19] Australian Securities and Investments Commission, 2019, Regulatory Guide 247 Effective disclosure in an operating and financial review, August, https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-247-effective-disclosure-in-an-operating-and-financial-review/, (accessed 2 September 2019).

Finally, in April 2019, the Australian Accounting Standards Board (AASB) and the Auditing and Assurance Standards Board (AUASB) issued joint guidance on the relevance of climate-related risks to accounting estimate materiality assessments (from asset fair values, impairments and changes in useful life assumptions to onerous contract provisions).[20] While TCFD-related disclosures are ordinarily focused within narrative portions of annual reports, the AASB/AUASB guidance is particularly significant in its repositioning of climate-related risks squarely within the scope of external audit scrutiny.

1.2.4 Non-financial risk

Sally Linwood
Senior Policy Advisor
Australian Institute of Company Directors

In 2019, the focus on non-financial risk as a critical governance issue continued to intensify.

Many of the findings from APRA's prudential inquiry into CBA[21] – including a lack of rigour and urgency in dealing with non-financial risks – were echoed to various degrees in the self-assessments of governance, culture and accountability undertaken by 36 other large APRA-regulated institutions.

A common theme that emerged in the self-assessments was the need for improvement in non-financial risk management. This was evidenced through a range of issues identified, including resource gaps (particularly in the compliance function), blurred roles and responsibilities for risk, and insufficient monitoring and oversight. Institutions acknowledged historical underinvestment in risk management systems and tools had also contributed to ineffective controls and processes.

In releasing its thematic report on the industry self-assessments, APRA deputy chair John Lonsdale said it was clear many of the issues identified within CBA are not unique to that institution. "Although the self-assessments raised no concerns about financial soundness, they confirmed our observation that industry is grappling to manage non-financial risks, such as culture and accountability," he said.[22]

At the same time, the Financial Services Royal Commission was a landmark event in governance, with revelations of misconduct creating shock waves across communities.

Board oversight of non-financial risk and the related issue of information flows to the board were in the spotlight.

In his final report, Commissioner Hayne observed that "the evidence before the Commission showed that too often, boards did not get the right information about emerging non-financial risks; did not do enough to seek further or better information where what they had was clearly deficient; and did not do enough with the information they had to oversee and challenge management's approach to these risks".[23]

[20] Australian Accounting Standards Board and Auditing and Assurance Standards Board, 2019, *Climate-related and other emerging risks disclosures: Assessing financial statement materiality using AASB/IASB Practice Statement 2*, April, https://www.aasb.gov.au/admin/file/content102/c3/AASB_AUASB_Joint_Bulletin_Finished.pdf, (accessed 2 September 2019).

[21] Australian Prudential Regulation Authority, 2018, *Prudential Inquiry into the Commonwealth Bank of Australia*, April, https://www.apra.gov.au/sites/default/files/CBA-Prudential-Inquiry_Final-Report_30042018.pdf, (accessed 15 August 2019).

[22] B McLean, 2019, *APRA releases report on industry self-assessments into governance, culture and accountability*, [media release], 22 May, Australian Prudential Regulation Authority, https://www.apra.gov.au/media-centre/media-releases/apra-releases-report-industry-self-assessments-governance-culture-and, (accessed 19 August 2019).

[23] K M Hayne, 2019, *Final Report Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Volume 1*, February, Commonwealth of Australia, p 395, https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf, (accessed 19 August 2019).

APRA has confirmed that in revising its prudential standards that apply across the financial services sector over the course of 2019, it will reflect the findings of its own inquiries as well as those of the Financial Services Royal Commission, including in relation to non-financial risk. Notably, APRA has stated that expectations of boards and senior management may well need to be articulated more clearly.

The shift in focus is not isolated to the financial services sector and all boards should be considering their risk management frameworks and satisfying themselves, on an ongoing basis, that their policies and processes are robust.

As Commissioner Hayne's final report highlighted, a fundamental tenet of governance is that boards and their 'gatekeeper committees' must provide rigorous oversight of risk, including non-financial risks.

1.2.5 New penalty regime for data privacy breaches

Malcolm Crompton AM FAICD
Founder and Lead Privacy Advisor
Information Integrity Solutions

Chong Shao
Senior Consultant
Information Integrity Solutions

2019 has been the year in which privacy law enforcement stepped up worldwide. In July, the US Federal Trade Commission fined Facebook US$5 billion for various privacy violations. This is the largest fine in the US Federal Trade Commission's history, and by far more than the total of all fines for privacy protection ever imposed globally. It followed two enforcement actions in Europe where the fines both exceeded AU$100 million.

In Australia, the power, means and willingness of the Office of the Australian Information Commissioner (OAIC) to respond to data privacy breaches is also increasing significantly.

The government announced in March 2019 that it will introduce a new penalty regime under the *Privacy Act 1988* (Cth). Notably, the amendments will:

- Increase the maximum penalty from AU$2.1 million for serious or repeated breaches, to AU$10 million or three times the value of any benefit obtained through data misuse or ten per cent of the organisation's annual domestic turnover, whichever is greater;
- Provide the OAIC with new infringement notice powers, with five-figure penalties for entities who fail to cooperate with efforts to resolve minor breaches.

The amendments were reiterated in the recommendations of the *Digital Platforms Inquiry Final Report* by the Australian Competition and Consumer Commission (ACCC) released in June 2019[24] and the five landmark cases against Facebook and Google over breaches in privacy, competition and consumer law launched in mid-August.

The government also announced an additional AU$25 million over three years for the OAIC to conduct its regulatory work.

Elsewhere, the *Treasury Laws Amendment (Consumer Data Right) Act 2019* introduces new privacy obligations, firstly on financial institutions but later also extending to the telecommunications and energy sectors. Enforcement will be delivered jointly by the ACCC and OAIC.

These legislative developments raise risks that directors should understand and for which they should prepare. In addition to large financial penalties, an enforceable undertaking – which must be signed off by the executive and monitored by the board – is a flexible and powerful tool for the OAIC to push for more systemic changes within entities.

These developments also highlight the board's role in establishing and promoting their organisation's overall privacy position. From a good governance perspective, an emphasis on privacy performance rather than privacy compliance allows the board to meet legal responsibilities and stakeholder expectations and build trust with both individuals and wider communities.

1.3 Director Liability

1.3.1 Insolvency safe harbour reform

Christie McGrath
Senior Policy Advisor
Australian Institute of Company Directors

Since amendments to the *Corporations Act 2001* (Cth) (the Corporations Act) became law on 18 September 2017, a "safe harbour" has been available for insolvent trading.

The AICD has published a Director Tool which provides directors with a comprehensive outline of the safe harbour provisions.[25]

The safe harbour excludes liability for insolvent trading under s 588G of the Corporations Act if, at a particular time after the director starts to suspect a company may become or be insolvent, he or she starts developing one or more courses of action that are reasonably likely to lead to a better outcome for the company.

The objective of the law reform was to encourage directors to pursue restructuring opportunities that could deliver a better outcome to stakeholders as compared with the immediate liquidation or administration of the company.

Forthcoming independent review

An independent review of the safe harbour provisions by a three-person panel is required to be undertaken as soon as practicable after the second anniversary of their introduction (likely to be late September 2019).

[24] Australian Competition and Consumer Commission, 2019, *Digital Platforms Inquiry Final Report*, June, https://www.accc.gov.au/system/files/Digital%20platforms%20inquiry%20-%20final%20report.pdf, (accessed 26 August 2019).

[25] Australian Institute of Company Directors, 2018, *The insolvency safe harbour*, Director Tools, https://aicd.companydirectors.com.au/resources/director-tools, (accessed 19 August 2019).

The review is required to comment on the impact of the availability of the safe harbour on directors (particularly the conduct of directors) and the interests of creditors and employees of those companies, as well as any other matters the Minister considers relevant.

The AICD was a strong advocate over many years for the introduction of the safe harbour provisions believing that the reform had the potential to energise business and the economy, by enabling directors to take common-sense steps to rehabilitate distressed companies.

The AICD will be closely engaged with the review and, in line with member feedback received to date, will be a strong voice promoting the value and success of the safe harbour reforms over the review period.

Feedback to date suggests that the safe harbour regime is a pragmatic tool that has proved valuable in the insolvency context. Advisers are of the view that the safe harbour regime is widely understood and been successfully utilised by ASX and larger private companies.

Specific feedback suggests that the safe harbour provisions are:

- allowing advisers to give a board (particularly non-executive directors) confidence that they can take reasonable risks to restructure or trade out of financial difficulties;
- changing the nature of board conversations and providing directors breathing space and time to restructure; and
- preserving value in distressed companies and delivering better outcomes for shareholders and creditors, even if the company enters into voluntary administration or becomes insolvent.

We have less visibility on how the safe harbour provisions are working for SMEs and start-ups. Initial discussions suggest there is an awareness of the availability of the safe harbour provisions but there remain cost issues associated with obtaining the right advice and concerns around how the regime can be used in practice.

1.3.2 Illegal phoenix activity and Fair Entitlements Guarantee

Christie McGrath
Senior Policy Advisor
Australian Institute of Company Directors

Illegal phoenixing involves the deliberate misuse of the corporate form. Phoenix companies ‘rise from the ashes’ with a new corporate structure that derives its assets and directors from an old entity, but in some cases improperly leave behind the old entity’s debts.

Combatting illegal phoenixing continues to be a focus of the Federal Government. In June 2019, the Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2019 was reintroduced to Federal Parliament in substantially the same form as the version that lapsed with the dissolution of Parliament earlier this year.

Before the Bill lapsed, the AICD lodged a submission with the Senate Economics Legislation Committee noting that we strongly support the Parliament’s aim of deterring and disrupting illegal phoenix activity.

We did, however, raise some concerns around requirements relating to backdating of director resignations and preventing the abandonment of companies that are not sufficiently targeted and may result in unintended consequences. The AICD will continue to engage with Parliament on a possible way forward to address these concerns.

Other reforms to address illegal phoenixing, such as the *Corporations Amendment (Strengthening Protections for Employee Entitlements) Act 2019* (Cth) are now in force.

The amendments to the *Corporations Act 2001* (Cth) (the Corporations Act) target employers and directors and officers who deliberately structure their business affairs to avoid paying employee entitlements during insolvencies and restructures.

The key amendments to the Corporations Act include:

- strengthening enforcement and recovery options to deter and penalise companies and company directors that evade their obligations and impact the recovery of employee entitlements. Notably, the fault element necessary to contravene the criminal provisions now only requires a director to have been "reckless" rather than having a specific intention to avoid the payment of employee entitlements;
- the introduction of new powers to disqualify directors where there have been two or more instances of corporate contraventions and insolvencies inappropriately relying on the Fair Entitlements Guarantee (FEG) scheme; and
- the ability to seek contributions from entities in a corporate group in certain circumstances to recover unpaid employee entitlements of another related entity.

The government is also separately pursuing the introduction of a director identification number, as part of its efforts to address illegal phoenix activity.

1.3.3 Director identification numbers

Christie McGrath
Senior Policy Advisor
Australian Institute of Company Directors

A director identification number (DIN) is a unique identifier for a person to verify their identity and consent to be a director of a company.

Draft legislation to facilitate modernising business registers and provide the legal framework for DINs lapsed with the dissolution of Parliament earlier this year and has not yet been reintroduced. It is unclear when the legislation will be reintroduced but the AICD hopes that this will happen in the near term as this is important legislation aimed at reducing the regulatory burden imposed on businesses.

The purpose of DINs is to prevent the use of fictitious identities and to circumvent the facilitation of illegal phoenixing or fraudulent activities such as setting up companies for dishonest purposes.

Once a DIN is issued, the DIN is a permanent identifier for that individual and will not expire even if that individual terminates their directorship with a particular company. The DIN will allow the individual's director activities and profile to be tracked over time.

While supporting the introduction of DINs, the AICD has advocated for the removal of directors' personal information from the public register (at the same time as the roll-out of DINs), due to concerns over identity fraud and safety and security issues of directors.

The AICD expects these matters will be considered once the draft legislation is reintroduced and the disclosure framework is developed.

Another portion of the lapsed legislation proposed a new *Commonwealth Registers Act* to cover 35 existing business registers, including the Australian Business Register, the Australian Company Number Register, the Business Names register, various registers of banned or disqualified persons and other information registers.

Essentially, the legislation proposed that the prescriptive requirements that apply to these registers encapsulated in various laws would be replaced with requirements for data standards and a disclosure framework.

The AICD will continue to be closely engaged with the government on the legislation once it is reintroduced.

1.3.4 Work health and safety

Christie McGrath
Senior Policy Advisor
Australian Institute of Company Directors

In 2018, Ms Marie Boland undertook a review of the model work health and safety (WHS) laws. The final report was released earlier this year and Safe Work Australia has released a consultation regulation impact statement on the findings of the review in recent months.[26]

Ms Boland found that the model WHS laws are largely operating as intended but identified a number of areas for improvement. The report made 34 recommendations in total and of relevance to directors, recommendations that:

- access to insurance for payment of WHS fines (but not legal costs) be prohibited on the basis that such insurance policies which cover the fines of those found guilty of breaching WHS laws have the potential to reduce compliance with the laws and undermine community confidence;
- a new offence of industrial manslaughter be introduced where the outcome of gross negligence by duty holders is the death of a person; and
- the fault threshold for the Category 1 offence be expanded to include 'gross negligence' on the basis that it will add an extra deterrent to the model WHS laws.

The AICD agrees with Ms Boland's findings that the introduction of the model WHS laws has led to a greater focus on WHS issues and elevated discussions to the board level. Importantly, the AICD considers that the model WHS Laws are working in accordance with their purpose and there is no need to change the overall framework.

Accordingly, the AICD lodged a submission on 5 August 2019 in response to Safe Work Australia's consultation and made the following points in respect of the above recommendations:

- There is no need for the prohibition on insurance for fines in a WHS context as the common law already adopts a carefully balanced approach to cases involving an insured seeking to claim under an insurance policy with respect to any alleged criminal liability.

[26] Safe Work Australia, *Review of the model WHS laws*, https://www.safeworkaustralia.gov.au/law-and-regulation/model-whs-laws/review-model-whs-laws, (accessed 19 August 2019).

- The introduction of an industrial manslaughter offence is not necessary given the existing criminal law offences and the Category 1 offence. The relevant regulators should be encouraged to prosecute individuals using these existing offences, rather than introducing new, potentially duplicative ones.
- Although the AICD does not consider it necessary to amend the Category 1 offence to include gross negligence, the AICD would not oppose its inclusion provided the high standard of gross negligence considered by Ms Boland is incorporated into the definition.

The AICD also continues to advocate for harmonisation of WHS laws across states and territories. This is crucial for organisations that operate across jurisdiction borders.

1.3.5 Understanding the basics of D&O insurance

Extracted from Tricia Hobson GAICD
"Ready for a rainy day"
Company Director, October 2019, AICD

The risk landscape for directors right now is complex and, it seems, ever increasing. Despite this, many directors don't fully understand how directors and officers liability (D&O) insurance works and take the view that as long as they have their company indemnity and know that the policy is in place, then this is comfort enough.

If you have a company of real means to support you, this may be okay. If you don't, this policy can be a director's personal lifeline in times of real need. It's one of the true personal assets you have for protection in challenging risk times.

And challenging risk times they certainly are. The impact of securities class actions is well known and explains the recent premium increases for larger companies (with a potential impact to smaller companies as insurers seek more modest increased premiums from them to make up for overall losses). The Hayne and other Royal Commissions are an obvious factor. Personal exposure for directors is on the rise with controversy around #MeToo, cybersecurity and environmental, social and governance (ESG) issues including climate change litigation. Regulatory actions and investigations are also likely to rise.

The *Corporations Act 2001* duties remain essentially the same but given the shift in the landscape in which directors are now acting, combined with ASIC's own why not litigate approach, a fresh round of cases will likely see the duty boundaries tested. Whether we like it or not, we have a litigious culture in Australia, second only to the US.

D&O insurance is likely to help in most of these situations. There are some risks the policy legally cannot cover given prohibitions under the *Corporations Act 2001* – mainly relating to acting wilfully and in bad faith – but the general nature of the cover is wide, despite the D&O market being under strain and premium prices increasing.

Not all policies are created equal and it is important to understand what cover you have – and, if it's not best in class, what you can do to get better terms at an acceptable price.

Standalone D&O policies are common for bigger companies. The trend over the past few years for smaller companies is for their D&O cover to be included in a management liability policy. There are some real variations in what is being offered in this class and some specific fundamentals to look out for include:

- Is there a "final adjudication clause" for advancement of defence costs?
- Who controls decision making?
- How much cover can really be accessed?
- Are investigations, fines and penalties covered?
- How can the best cover at the best price be negotiated?
- Who decides on which lawyer?

Lastly, it's important to court the underwriter by selling your good work as a director. Make sure proper care is taken over the proposal form and provide as much relevant supporting information as possible as to why your company is financially and culturally sound, a good corporate citizen and therefore a good risk.

1.3.6 The D&O insurance market

Ewen McKay
Product Leader Management Liability Australia
AXA XL, a division of AXA

The Australian directors and officers liability (D&O) insurance market has seen significant changes over the last two years, as the insurance cycle has entered a 'hardening' phase characterised by increasing premiums and reduced underwriting capacity.

This is particularly the case for D&O policies that provide cover to the company itself for securities claims (often referred to as "Side C" cover). Year-on-year premium increases of over 50 per cent have become common for this type of insurance, with some reaching 400 per cent or more. This has been coupled with the majority of D&O insurers reducing underwriting capacity or, in some cases, withdrawing from perceived 'high-risk' industry sectors (and in at least one case completely exiting the D&O market).

How did it come to this?

For the period from 1999 (when the first shareholder class action in Australia was launched) to 2011, there was an average of two shareholder class actions per year against Australian companies. From 2011 onwards, the average is more than seven. And in the last few years, it has grown to 10 claims a year. In insurance terms, the claims frequency has increased five-fold in six years.

Add to this that, historically, nine out of ten shareholder class actions have been finalised by a settlement between the parties for an average of just under AU$50 million (plus defence costs).

The available evidence points to continuing deterioration of the D&O insurance market. Nearly half of all shareholder class actions ever commenced in Australia are in the litigation pipeline awaiting resolution. These unresolved claims are yet to be fully quantified and recognised in the D&O market's underwriting results. As these settlements ultimately flow through to D&O insurers, their impact is likely to be felt over a relatively concentrated period of three to four years resulting in probably the worst ever year-on-year underwriting losses for the Australian D&O market.

It is therefore difficult to see much prospect of imminent relief for D&O insurance premiums.

1.3.7 Corporate criminal responsibility regime review

Christie McGrath
Senior Policy Advisor
Australian Institute of Company Directors

On the eve of this year's federal election, the Attorney-General Christian Porter, tasked the Australian Law Reform Commission (ALRC) with examining Australia's corporate criminal responsibility regime, including the ability to attribute liability to individuals for corporate misconduct.

The ALRC has been encouraged to consult widely on the relevant issues, and report by 30 April 2020. A discussion paper is expected to be released in mid-November 2019.

The terms of reference require the ALRC to consider reforms that are necessary and/ or desirable to improve Australia's corporate criminal liability regime. Key areas of focus include:

- the efficacy of the Criminal Code as a mechanism for attributing corporate criminal liability;
- the availability of other mechanisms for attributing corporate criminal responsibility and their effectiveness, including mechanisms which could be used to hold individuals liable for corporate misconduct; and
- options for reforming the Code or other relevant legislation to strengthen and simplify the Commonwealth corporate criminal responsibility regime.

These are core issues for the AICD and we will be an active participant over the course of the inquiry, seeking an evidence-based approach to policy recommendations.

A key challenge for the ALRC is that the current legal framework regarding corporate criminal responsibility has rarely been tested, meaning the precise bounds of the law remain unclear. Therefore, a fundamental question for the ALRC to answer will be whether the current legal framework has structural weaknesses or has not been enforced due to regulators being unwilling (or appropriately resourced) to pursue criminal prosecutions.

Under Australian law, directors can be exposed to significant direct criminal (or civil) liabilities for a breach of their duties, as well as for other contraventions of the *Corporations Act 2001* (Cth) or other pieces of legislation including Australian, consumer, environmental and WHS laws. Further, a director may be liable as an accessory in a corporation's offence in accordance with the rules regarding accessorial liability.

To gain a holistic picture of Australia's director liability regime (both civil and criminal), and to assist with our participation in the review, the AICD is working with a major law firm to undertake a comparative analysis of international director liability regimes. The results of this analysis will be shared with members.

1.3.8 Penalties

Sally Linwood
Senior Policy Advisor
Australian Institute of Company Directors

In early 2019, legislative reforms were introduced that significantly lifted financial sector and corporate penalties and expanded the civil penalty regime.

The stronger penalties underscore the substantial obligations under the law on both directors and officers. Legal duties and obligations will be top of mind for directors and will compel a closer look at risk and compliance management policies and processes.

Key reforms include the following:

- The civil penalty regime has been extended to additional obligations under the *Corporations Act 2001* (the Corporations Act) (including obligations owed by Australian Financial Services Licence (AFSL) holders to do all things necessary to ensure the financial services covered by the licence are provided efficiently, honestly and fairly, and to report significant breaches or likely breaches to ASIC within 10 business days of becoming aware of the breach or likely breach).
- The quantum of civil penalties has been increased - for an individual, to the greater of 5,000 penalty units ($1,050,000) or the benefit derived (or detriment avoided) because of the contravention multiplied by three.
- Courts now have an ability to make a relinquishment order to recover any financial benefit that might have been gained from misconduct.
- Maximum imprisonment penalties for certain criminal offences have been increased to reflect the seriousness of the misconduct. Notably, terms of imprisonment have been increased from five years to 15 years for certain serious criminal offences including recklessly or dishonestly breaching directors' and officers' duties (s 184 of the Corporations Act).
- Financial penalties for criminal offences have been increased (for individuals, up to the greater of 4,500 penalty units ($945,000) or three times the benefit derived from or detriment avoided by the contravention).
- 'Dishonest' is now specifically defined in the Corporations Act as 'dishonest according to the standards of ordinary people'. This may lead to more attempted prosecutions under offences that rely on this concept, although legal experts suggest the practical impact may be limited.
- Anyone 'involved in' the contravention of a civil penalty provision will now be liable for the contravention (previously an ad-hoc approach was taken). A person is only involved in a contravention if there is some culpability on their part: for example, if they aided and abetted, induced or were 'knowingly concerned' in the contravention.

When combined with ASIC's newly adopted 'why not litigate' approach, the stronger penalties mark an important shift in the liability landscape for directors.

1.4 Remuneration

1.4.1 Executive remuneration

Sally Linwood
Senior Policy Advisor
Australian Institute of Company Directors

Post the Financial Services Royal Commission, executive remuneration continues to be a focal point for boards, regulators and other stakeholders.

Commissioner Hayne engaged in detailed discussion on culture, governance and remuneration in his final report, highlighting their importance in the misconduct examined by the Financial Services Royal Commission. He ultimately made a number of remuneration-focused recommendations including in relation to APRA's approach to supervision and their prudential standards.

Regulatory expectations and scrutiny have since been heightened, with ASIC focusing on board decision making in relation to variable executive remuneration as part of its Corporate Governance Taskforce[27] and APRA releasing for consultation a new draft prudential standard on remuneration and overseeing the implementation of the Banking Executive Accountability Regime (BEAR), which is now live for all banks and includes specific requirements in relation to remuneration.

At the same time, investors have continued to wield their power under the 'two strikes rule', with record votes against listed company remuneration reports being recorded at a number of bank AGMs in late 2018.

In its proposed remuneration standard, APRA underscores the need to strengthen board oversight and governance of remuneration, access to information, coordination in making remuneration decisions and senior management accountability. The proposed standard is more prescriptive than APRA's current guidance, with a strong focus on risk management.

Key proposals include an expanded board role, including in approving and actively overseeing an organisation's remuneration policy and approving remuneration arrangements and outcomes for a broader pool of people, a 50 per cent cap on financial metrics and extension of deferrals periods.

Also this year, Stephen Sedgwick AO completed an interim review into implementation of his 2017 recommendations on remuneration for retail bank staff. Progress has occurred but, according to Commissioner Hayne, this is only the first step – banks will need to continue to consider how their variable remuneration systems are structured and whether they are geared not only to what employees do but how they do it.

Executive remuneration remains a focus for investors from both a practice and policy perspective. Notably, in 2019 the Australian Council of Superannuation Investors (ACSI) released a number of policy proposals intended to improve corporate accountability including two remuneration-focused proposals: introducing a binding vote on remuneration policy every three years and disclosing CEO-median worker pay ratios to shareholders.

Executive remuneration will continue to present challenges for boards. Listed company boards face pressure to balance competing demands from different sets of stakeholders, including investors, proxy advisers, regulators and customers. Overall, it is clear that robust remuneration governance arrangements are critical and that boards will need to critically examine whether current structures remain fit for purpose.

[27] J Price, 2019, "ASIC surveys corporate governance practices of ASX 200 companies", *Company Director*, 1 May, https://aicd.companydirectors.com.au/membership/company-director-magazine/2019-back-editions/may/regulator, (accessed 2 September 2019).

2. The Business Environment

Sustainability and long-term growth prospects continue to be the main issues that keep directors 'awake at night'. Structural change/changing business models, legal and regulatory compliance, corporate culture and data security were also pertinent.

2.1 Australian Business

2.1.1 AICD Director Sentiment Index

Matt Pritchard
Head of Government Relations and Media
Australian Institute of Company Directors

In April 2019, the AICD released our latest Director Sentiment Index (DSI) results. The DSI is currently the only indicator measuring the opinions and future intentions of directors on a range of issues including the Australian and world economies, government policy and governance regulations.

Overall director sentiment hit negative territory for the first time in 18 months, declining 21.1 points since the last survey to negative 16.9 overall. The decline was largely due to increased pessimism about domestic and global economies. In addition, directors were far more pessimistic about conditions for their own business.

Directors nominated climate change as the number one issue they want the Federal Government to address in the long term. Significantly, directors also nominated it as the number two issue for the Federal Government to address in the short term. The percentage of directors nominating it as a short-term issue increased substantially since the previous survey.

Directors continued to prioritise renewable energy sources as the top priority for additional infrastructure investment. This is followed by regional infrastructure and water supply.

When asked to nominate steps directors needed to take to regain and rebuild public trust, directors once again nominated demonstrating respect for customers/clients/communities, trustworthiness of leadership and improving corporate culture.

Sustainability and long-term growth prospects continue to be the main issues that keep directors 'awake at night'. Structural change/changing business models, legal and regulatory compliance, corporate culture and data security were also pertinent.

Perhaps unsurprisingly, given the current governance landscape, 91 per cent of directors said their board is focused on effecting cultural change in their organisation.

2.1.2 Australian economic update

Mark Thirlwell
Chief Economist
Australian Institute of Company Directors

Below-target inflation, sub-trend economic growth, spare labour market capacity and a weak household sector have seen the cash rate fall to the unprecedentedly low level of one per cent.

After no change between August 2016 and May 2019, the RBA delivered consecutive rate cuts in June and July this year and financial markets think it isn't done: market pricing has the cash rate hitting 0.75 per cent before end-2019 and just 0.5 per cent in H1:2020. The yield on the ten-year Australian government bond has already dipped below one per cent while the prospect of lower rates, plus the triple threat of trade, technology and currency wars, has seen the Australian dollar test ten-year lows against the greenback.

Monetary policy is responding to an under-performing economy. Annual real GDP growth slipped to just 1.8 per cent in the first quarter of this year, well below Australia's estimated trend growth rate of around 2.75 per cent. Likewise, the unemployment rate – which has held relatively steady at around 5.2 per cent in recent months – is above the RBA's new estimate of an equilibrium unemployment rate of closer to 4.5 per cent. Underemployment, at more than eight per cent, also remains stubbornly high. At 1.6 per cent, inflation is stuck below the bottom of the RBA's target band. And households have been suffering from an uncomfortable combination of sluggish wage growth, falling house prices and high debt levels that has dampened consumption growth.

It's not all bad news. Australia's external performance has been strong, with high commodity prices and rising LNG exports contributing to a sequence of record monthly trade surpluses and boosting the government's coffers while policy adjustments and a post-election decline in uncertainty appear to have stemmed the fall in house prices.

Looking ahead, low interest rates plus government tax measures should provide some relief for household incomes. But if something goes wrong in the global economy, the RBA is now extremely low on conventional policy ammunition.

Based on data as of 14 August 2019.

2.2 International Business

2.2.1 Global economic update

Mark Thirlwell
Chief Economist
Australian Institute of Company Directors

A volatile and unpredictable global environment continues to pose challenges for risk management and strategic planning. Meanwhile, official forecasts see global growth at only a little above three per cent this year, which would be the weakest outcome since 2009.

High levels of policy uncertainty, dominated by the confrontation between Washington and Beijing, have taken a toll on international trade, manufacturing and investment as what started as a trade conflict has expanded to encompass technology and now currency wars. The latest escalation came when President Trump threatened to impose a ten per cent tariff rate on an additional US$300 billion of Chinese imports from September this year. Beijing responded by allowing the yuan to weaken through the psychologically important level of seven to the US dollar for the first time in a decade, in turn prompting the US Treasury to designate China as a currency manipulator. President Trump has since backtracked partially on the tariff increases but with a US presidential election campaign pending and Beijing grappling with protests in Hong Kong, politics could further complicate matters.

US-China-related policy uncertainty has been compounded by several other trade disputes, the persistent possibility of a hard Brexit, continuing policy challenges elsewhere in the EU, and tensions in the Persian Gulf. Add to that mix the general vulnerabilities created by high worldwide debt levels, China's conflicting growth and stability policy objectives and a growing strand of populist politics, and the world economy faces a range of downside risks.

Central banks have responded with monetary policy easing, with the US Federal Reserve joining the global shift and cutting rates in July for the first time since December 2008. Virtually every major central bank is now expected to ease policy again over the next six months. But low rates and faltering growth expectations are also distorting global financial markets, with some US$15 trillion (about 25 per cent) of bonds now trading with a negative yield.

'Interesting times' indeed.

Based on data as of 14 August 2019.

2.3 Innovation

2.3.1 Directors' playbook: The future of work

Geoff Mason
Innovation Consultant
Australian Institute of Company Directors

Definitions of the future of work range from the application of technologies such as artificial intelligence and robotics to human output, through to the destabilisation of geopolitical borders, globalisation and profound changes to human working environments. This broad spectrum highlights the complex and uncertain environment within which Australian boardrooms now operate and the corresponding need for directors to continually refresh their skills and experience.

In late 2018, the AICD and Deloitte published the *Directors' playbook: The future of work.*[28] The publication explores evidence on changing workforce trends from a governance perspective, and also provides practical advice and questions for directors to consider on the role of boards in governing the future of work.

One of the most important trends for boards to consider is how to lead decisions that require emotional and ethical judgements, within the context of organisations where an increasing number of decisions are made by artificial intelligence.

Directors' playbook: The future of work addresses three core areas within boardroom future-of-work agendas: how the nature of work is changing; how the role of the worker is evolving; and how the workplace must adapt to carry out the organisation's work.

It examines how the nature of work is shifting from manual to more mindful tasks, how technology will augment workforces requiring adjustments in workforce capability and composition, and what physical, digital, cultural and structural changes will be required within workplaces and workplace structures to meet new demands.

It guides directors to reflect on these subjects through the lenses of strategy, resources, performance, compliance, risk and accountability, and in so doing provides an understanding of how strategic decisions will impact the organisation and the collective interests of its stakeholders.

[28] D Rumbens et al, 2018, *Directors' playbook: The future of work*, Governance Leadership Centre Research Series, October, Australian Institute of Company Directors and Deloitte, https://aicd.companydirectors.com.au/-/media/cd2/resources/advocacy/governance-leadership-centre/pdf/glc-directors-playbook-on-the-future-of-work.ashx, (accessed 27 August 2019).

2.3.2 AICD Innovation Study

Geoff Mason
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Australian Institute of Company Directors

The AICD has partnered with the University of Sydney Business School to examine the significance, importance and prioritisation of innovation among Australian boards. The study takes a first step in understanding how boards view and act on innovation in Australia.

The final report, *Driving Innovation: The Boardroom Gap*, was released on 18 September 2019 and can be found at www.aicd.com.au/drivinginnovation.

The study found that innovation is being prioritised at the strategic level, but boards are not tracking the delivery of innovation agendas. Boards may also be too focused on short-term financial performance or compliance issues at the expense of considering opportunities to create new value for their organisations.

Not unexpectedly, the study found Australian boards have low technology, innovation, science or engineering expertise. It also found that innovation or technology is not a strong focus within recruitment skills matrices, and that directors tend to seek advice from the director community more than seeking out experts on innovation matters. This highlights a gap in expertise, with a large cohort of directors indicating they don't believe their boards have the right mix of skills and experience to assess the ethical and practical implications of using modern technologies, and the impact on their organisations and society more broadly.

Boards also appear to be underestimating the threats posed by new technologies or evolving business models. In risk matrices, respondents identified disruption risks presented by technology, changing commercial environments and workforces, almost half as much as traditional strategic, financial and operational risks.

Importantly, half of the respondents surveyed saw innovation as a collaborative effort with their executive team. The research shows those boards who collaborated with their executive team performed better in terms of achieving innovation outcomes.

The report recommends five key actions for boards to consider, to help address the boardroom innovation gap:

1. lift directors' technology and digital literacy;
2. set clear expectations of management regarding calculated risk taking to drive innovation;
3. develop a shared language with management, and clear narrative for investors/members on innovation;
4. ensure innovation features regularly on boardroom agendas; and
5. establish a budget and executive incentives for long-term innovation.

Globally there is little data that specifically examines the role of innovation in the governance context. These findings will help the AICD better understand how directors view innovation and how governance can be used to drive innovative activity across the breadth of sectors in Australia.

3. The Regulatory Environment

Director accountability for non-financial risks is about to take a step up. Set risk appetite and start where the risk of harm is greatest. Examine assumptions about who your stakeholders are, and then listen to them, and learn from leading practice.

3.1 Legislative Reform

3.1.1 Corporate whistleblower reform

Rachel Nicolson
Partner
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From 1 July 2019, Australia's corporate whistleblower protections expanded (to encompass more people as eligible whistleblowers and a wider range of subject matter (including tax matters) as protected disclosures) and strengthened (to ensure whistleblowers have greater protections under the law).

Coverage

Most of the protections for whistleblowers will attach where a whistleblower makes a disclosure to an eligible recipient (or ASIC, APRA or a lawyer) and has reasonable grounds to suspect that the disclosure relates to "misconduct or an improper state of affairs or circumstances" in relation to an entity (or related entity) regulated by the *Corporations Act 2001* (Cth) (the Corporations Act). Eligible recipients include officers (including directors), senior managers, auditors, actuaries and persons authorised by the company to be eligible recipients.

A wider range of individuals can now be eligible whistleblowers including past and present officers, employees and contractors as well as their relatives and dependents. The new laws have abolished the old requirements that whistleblowers act in good faith and identify themselves (meaning anonymous disclosures are now protected).

Whistleblower policies

Public and large proprietary companies must have a whistleblower policy that contains required content set out in the Corporations Act by 1 January 2020 and make that policy available to officers and employees. ASIC has recently released guidance on whistleblower policies.

Protections that apply

Where a whistleblower makes a protected disclosure, they are entitled to certain protections including:

- protection from civil, criminal or administrative legal action (including disciplinary action) for making the disclosure;
- no contractual or other right can be enforced because of making the disclosure (for example, an employment agreement cannot be terminated for making a report); and
- in some circumstances, protection from giving evidence in legal proceedings.

Anybody (not just whistleblowers) can obtain compensation and other remedies where they are subjected to detrimental conduct, which is conduct that causes detriment as a result of the offender suspecting that they or someone else could make a disclosure that is protected under the law.

Liability for confidentiality and detrimental conduct

Individuals and companies face steep penalties where they breach confidentiality or engage in detrimental conduct. Penalties for individuals include imprisonment and civil penalties of over $1 million. Companies should ensure that all eligible recipients (including at the board and senior executives) are adequately trained on appropriate procedures to avoid breaching their confidentiality obligations and take active steps to prevent detrimental conduct.

Bounties

Although bounties for whistleblowers featured during consultation on the new laws, they were not included in the new laws and so not available to whistleblowers in Australia.

3.1.2 Modern slavery reporting requirements

Richard Boele
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KPMG Banarra

The *Modern Slavery Act 2018* (Cth) commenced on 1 January 2019, and the *NSW Modern Slavery Act 2018* (NSW) has been deferred and is currently under review by the NSW Legislative Council Standing Committee on Social Issues.

This new legislation requires boards of organisations based or operating in Australia to approve a mandatory, public, annual statement on the human rights risks of forced labour, debt bondage, trafficking and other slavery-like practices in their operations and supply chains. For many large organisations, the first annual reporting period began on 1 July 2019.

We met with over 150 directors in the last 12 months to discuss this responsibility and offer here two insights from those conversations: business and human rights is not a zero-sum game, and director accountability for non-financial risk needs to mature.

Human rights is not a zero-sum game

While directors are clearly grappling with the organisational tensions that surface from the *Modern Slavery Act 2018* – compliance versus strategy, risk versus opportunity, profit versus trust – our conversations revealed that these are not 'either or' propositions. Profit, and in particular growth, are only secured with stakeholder and community acceptance of an organisation. This means business needs a systematic and defensible approach to dealing with the risks of negatively impacting people.

Insightful directors are already framing questions of management with an opportunity lens. We heard about opportunities to create supply chain efficiencies, deeper supplier relationships and to cultivate community partnerships. Others were already creating differentiated products in the market using technology to assure quality, origin and the absence of harm to people. Prioritising these human rights considerations can build trust, offer a framework for strategic decision making and create opportunities for doing business better.

Director accountability for non-financial risks needs to mature

Throughout our research, directors wanted to talk about the difficult intersection between human rights, culture and values. And the most frequent question underlying this complex discussion is: Where do we practically start?

Firstly, it is about effective governance. When the APRA CBA report[29] said directors had a 'tin ear' to community expectations about fair treatment, it was talking about a fundamental failure to listen to people, particularly the most vulnerable.

And secondly, it is about the corporate responsibility to respect human rights. The United Nations' *Guiding Principles on Business and Human Rights*[30] draws a line in the sand by clarifying that business can no longer choose to be wilfully blind to how its activities impact on people.

Mandatory modern slavery reporting crystallises these evolving expectations by asking business to take the first steps: exercise due diligence to identify where people are at risk of harm, take action to prevent it, or remediate it.

[29] Australian Prudential Regulation Authority, 2018, *Prudential Inquiry into the Commonwealth Bank of Australia*, April, https://www.apra.gov.au/sites/default/files/CBA-Prudential-Inquiry_Final-Report_30042018.pdf, (accessed 15 August 2019).

[30] United Nations Human Rights Office of the High Commissioner, 2011, *Guiding Principles on Business and Human Rights*, United Nations, https://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf, (accessed 15 August 2019).

In this sense, and despite very valid questions about scope and scale, director accountability for non-financial risks is about to take a step up. Set risk appetite and start where the risk of harm is greatest. Examine assumptions about who your stakeholders are, and then listen to them, and learn from leading practice.

3.1.3 Class actions review

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Christine Tran
Senior Associate
Herbert Smith Freehills

Class actions, and in particular shareholder class action claims, continue to transform the litigation environment in Australia. The latest empirical data indicates that shareholder claims account for 75 per cent of funded class actions and represent the fastest growing species of class action in Australia.[31] They are responsible for transferring billions of dollars through settlements, with global insurers footing a significant proportion of that bill. D&O insurance premiums have accordingly increased significantly, with AON recently reporting that ASX200 firms experienced a median 122 per cent increase in primary premiums in the second half of 2018 and an 89 per cent increase in the first half of 2019.[32]

In 2018, the effectiveness of class action litigation was considered by the Australian Law Reform Commission (ALRC). The ALRC's Report 134[33], tabled before Parliament in January 2019, put forward 24 recommendations for reform. The recommendations focus on promoting efficacy of the class actions system and the integrity of third-party funded class actions, such as mechanisms to deal with competing class actions. The ALRC also recommended that the Federal Government review the legal and economic impact of the continuous disclosure regime, which is a fundamental building block of Australian shareholder class actions.

Shareholder class actions rarely proceed to trial and none have yet proceeded to judgment. In the last 12 months, two shareholder class actions proceeded to trial, with one settling during trial and the other currently awaiting judgment.[34] If judgment is handed down, it will be the first for a shareholder class action and will likely provide guidance on many difficult issues in shareholder class actions (including how the disclosure regime is implemented, how damages are calculated, and appropriate causation methodologies).

The jurisprudence on competing class actions remains in a state of flux. Increasingly, courts are asked to resolve competing class actions by different funders and law firms against the same respondents, relating to the same subject-matter, but with differing claim periods, overlapping group member definitions and varying allegations. The solutions identified by the courts are varied.[35] We expect competing shareholder class actions to continue to shape the class action jurisprudence in Australia.

[31] Refer to V Morabito's discussion on his latest empirical perspectives of class actions in Australia, G Doogue, 2019, "The business of class actions", *Saturday Extra*, ABC Radio National, 20 July, https://www.abc.net.au/radionational/programs/saturdayextra/have-class-actions-become-more-about-business,-than-justice/11323334, (accessed 20 August 2019).

[32] C Merritt, 2019, "Class actions drive up cost of directors and officers insurance", *The Australian*, 30 April.

[33] Australian Law Reform Commission, 2018, *Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* (Report 134, 2018), December, https://www.alrc.gov.au/wp-content/uploads/2019/08/alrc_report_134_webaccess_2.pdf, (accessed 20 August 2019). Note that a similar review was undertaken by the Victorian Law Reform Commission (VLRC) following a referral from the Attorney-General of Victoria. The VLRC's report on Access to Justice: Litigation Funding and Group Proceedings was tabled in the Victorian Parliament on 19 June 2018.

[34] Respectively, *Pawel Kuterba & Anor v Sirtex Medical Limited* (VID1375/2017); *TPT Patrol Pty Ltd as trustee for Amies Superannuation Fund v Myer Holdings Limited* (VID1494/2016).

[35] See for example: *Perera v GetSwift Ltd* (2018) 363 ALR 394; *Southernwood v Brambles Ltd* [2019] FCA 1021; *Klemweb Nominees Pty Ltd (atf Klemweb Superannuation Fund) v BHP Group Ltd* [2019] FCAFC 107; *Zonia Holdings Pty Ltd v Commonwealth Bank of Australia Ltd (No 2)* [2019] FCA 1061; *Wigmans and others v AMP Ltd* [2019] NSWSC 603.

3.2 Australian Securities and Investments Commission

3.2.1 Regulatory and enforcement priorities

John Price
Commissioner
Australian Securities and Investments Commission

As Australia's integrated corporate, markets, financial services and consumer credit regulator, the Australian Securities and Investments Commission's (ASIC) vision is for a fair, strong and efficient financial system for all Australians.

Strategic change program

In 2018, we began our strategic change program and will continue to implement it over the next four years.[36] This program includes:

- a new enforcement strategy, which focuses on increased and accelerated court-based outcomes overseen by ASIC'S Office of Enforcement and underpinned by the discipline of 'why not litigate?';
- more intensive supervision to improve the culture and behaviour of financial firms and to enhance governance practices, particularly through our Close & Continuous Monitoring program and our Corporate Governance Taskforce[37] aimed at improving governance practices at the board level;
- greater use of next-generation technology such as artificial intelligence, data analytics and behavioural sciences to better harness industry data, and behavioural insights to better understand what drives certain behaviours and how to influence them for the better; and
- a new internal governance framework to support effective decision making.

As part of this change program, we are committed to implementing the recommendations of the Financial Services Royal Commission (for example, we are working towards an expanded role for ASIC as the primary conduct regulator in superannuation).

Key priorities

We have identified a number of principal strategic priorities to give effect to our vision, and these priorities represent the most significant ways in which we are addressing consumer harm, punishing wrongdoing, and encouraging better culture and behaviour (including a greater emphasis on fairness and professionalism) in businesses.

Our strategic priorities interact with the Financial Services Royal Commission's recommendations and we continue to implement those recommendations:

- We continue to progress the investigations and litigation arising from the 13 Royal Commission referrals and 32 case studies relevant to ASIC.
- We are deploying new product governance tools (that is, the financial product design and distribution obligations and ASIC's new product intervention power).
- We established the Office of Enforcement, responsible to the Commission for enhancing the investigation of contraventions and enforcement of the laws that ASIC administers.

[36] For more information, refer to *ASIC's Corporate Plan 2019–23*, https://download.asic.gov.au/media/5248811/corporate-plan-2019-23-published-28-august-2019.pdf, (accessed 28 August 2019).

[37] J Price, 2019, "ASIC surveys corporate governance practices of ASX 200 companies", *Company Director*, 1 May, https://aicd.companydirectors.com.au/membership/company-director-magazine/2019-back-editions/may/regulator, (accessed 2 September 2019).

- We continue to implement measures that do not require legislative change (for example, reporting on the extent to which product issuers are acting to end the grandfathering of conflicted remuneration).
- We are working with APRA to formalise and strengthen our information-sharing arrangements and to update our memorandum of understanding to reflect our closer working relationship.
- We continue to engage with other international and domestic regulators and agencies (for example, the ACCC, the Australian Transaction Reports and Analysis Centre (AUSTRAC), the Australian Financial Complaints Authority (AFCA) and the New Zealand Financial Markets Authority).

We recognise the importance of strengthening our own capabilities to ensure we have the right people and the right tools to do our job. By doing so, we aim to position ASIC as a strategic and agile regulator. To this end, we are also:

- building up ASIC's capability in behavioural sciences, data and technology;
- developing and using new regulatory tools and remedies (in particular, we are thinking about greater use of regulatory tools other than just disclosure); and
- employing more personnel to deliver these outcomes.

3.3 Australian Competition and Consumer Commission

3.3.1 Compliance and enforcement priorities

Rod Sims
Chair
Australian Competition and Consumer Commission

As Australia's peak consumer protection and competition agency, the Australian Competition and Consumer Commission (ACCC) is continually looking at ways to improve our effectiveness in enforcing the *Competition and Consumer Act 2010*.

While we are ready to take action against companies, and their directors where warranted, we do need to make tough choices to ensure effective use of very limited enforcement resources.

With that aim, we have established our annual compliance and enforcement priorities. In 2019, these included:

- consumer guarantees on high-value electrical and white good products, in particular those supplied by large retailers and manufacturers;
- conduct that may contravene the misuse of market power provisions and the concerted practices provisions;
- anti-competitive conduct and competition issues in the financial services sector, including issues with respect to foreign exchange services;
- consumer and competition issues arising from opaque and complex pricing of essential services, in particular those in energy and telecommunications;

- the impact on consumers arising from the collection and use of consumer data by digital platforms, with a focus on the transparency of data practices and the adequacy of disclosure to consumers;
- competition and consumer issues arising from customer loyalty schemes;
- emerging consumer issues in advertising and subscription service practices on social media platforms, with a focus on the impact on younger consumers;
- ensuring that small businesses receive the protections under the *Competition and Consumer Act 2010*, with a focus on the Franchising Code of Conduct and unfair contract terms;
- competition and fair trading issues in the agriculture sector; and
- anti-competitive conduct and unfair business practices impacting competition in commercial construction markets.

While the ACCC actively focuses on these current priority areas, we always retain capacity to pursue other matters where consumer or corporate conduct is of significant public interest or concern.

Our increased use of market studies is playing an important role in defining the ACCC's compliance and enforcement priorities as well as keeping us better informed of what might, or might not be, working in particular markets. They give us a broad understanding of what is affecting customers and businesses, as well as how we might drive compliance, improve competition and create better functioning markets.

The ACCC has long advocated for stronger penalties, and equivalent penalties for contraventions of consumer and competition law. The 2018 amendments of the Australian Consumer Law, which increased penalties for contraventions, now allow the ACCC to seek increased penalties in appropriate consumer law cases.

This has reinforced our belief in the importance of pursuing serious sanctions when necessary, as a form of deterrence as well as a way of ensuring the wider community can maintain faith in a market economy working for them.

3.4 Australian Taxation Office

3.4.1 Justified trust

Rebecca Saint
Deputy Commissioner
Public Groups and International
Australian Tax Office

The Australian Taxation Office's (ATO) justified trust program[38], part of the Tax Avoidance Taskforce, aims to assure community confidence that our largest corporate taxpayers are paying the right amount of income tax, GST, excise and PRRT.

Corporate groups who work with us to achieve justified trust have certainty and confidence in their tax affairs and reduced compliance costs in future years where their arrangements remain largely unchanged. This level of risk mitigation is something we would expect to be the aim of every company director.

[38] More information can be found on the ATO's justified trust program at https://www.ato.gov.au/business/large-business/justified-trust/, (accessed 20 August 2019).

We are now into the fourth year of the justified trust program and have conducted over 1,000 reviews. We have achieved a medium to high level of assurance in many of these cases.

This year we will increase our focus on those corporate groups where we have low assurance to this point. We are tailoring our engagement with these corporate groups based on their specific circumstances and areas requiring further assurance. We will prioritise our next actions to address high risk areas first.

We also continue to focus on ways to improve the client experience. Earlier this year we removed internal structural impediments so our people can provide a more holistic service across the tax and superannuation system. This will also enable us to deliver a more integrated 'whole of tax' assurance program while decreasing compliance costs for taxpayers.

Company directors play a fundamental role in ensuring their company's affairs are able to achieve justified trust with the ATO. Ensuring the company's governance framework has clear controls and processes to identify, assess and manage tax and superannuation risks is an obvious priority for all directors. Having strong tax risk management and effective compliance processes provides a solid basis to achieving justified trust.

3.5 Australian Prudential Regulation Authority

3.5.1 Regulatory priorities

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MinterEllison

Kate Hilder
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MinterEllison

Following the Financial Services Royal Commission, and a number of corporate scandals that have damaged public trust in the financial services sector, governance, culture, remuneration and accountability have become, and are set to remain, a key focus for the Australian Prudential Regulation Authority (APRA). The scope of APRA's remit has expanded to include a sharper focus on non-financial risk.[39] APRA's expectation is that entities follow suit.[40]

As APRA starts to action the recommendations of the Financial Services Royal Commission, and to formulate actions in response to the recommendations of the *Capability Review,*[41] we have also seen a shift in the way in which it articulates and approaches engagement, supervision and enforcement. With respect to enforcement, APRA's new 'constructively tough' approach can best be characterised as a shift from an enforcement appetite of last resort to an approach that will see the regulator willing

[39] House of Representatives, Standing Committee on Economics, 2019, *Australian Prudential Regulation Authority annual report 2017-2018*, Commonwealth of Australia, 9 August, [transcript of committee Hansard], https://parlinfo.aph.gov.au/parlInfo/download/committees/commrep/db5a41ee-8d0c-41a6-831e-5f52607974dd/toc_pdf/Standing%20Committee%20on%20Economics_2019_08_09_7101.pdf;fileType=application%2Fpdf#search=%22committees/commrep/db5a41ee-8d0c-41a6-831e-5f52607974dd/0000%22, (accessed 20 August 2019).

[40] Australian Prudential Regulation Authority, 2019, *APRA releases report on industry self-assessments into governance, culture and accountability*, [media release], 22 May, https://www.apra.gov.au/media-centre/media-releases/apra-releases-report-industry-self-assessments-governance-culture-and, (accessed 28 August 2019).

[41] Australian Prudential Regulation Authority, 2019, *APRA welcomes Capability Review report and outlines action plan*, [media release], 17 July, https://www.apra.gov.au/media-centre/media-releases/apra-welcomes-capability-review-report-and-outlines-action-plan, (accessed 28 August 2019).

to use the full suite of tools available to address non-compliance, and to do so more swiftly and more transparently than has previously been the case.[42] APRA's actions in imposing additional capital requirements on entities for governance failings is one example of this new, more public and more forceful approach.

Further, APRA is also adopting both a more prescriptive and a more hands-on approach to its supervision and monitoring activities. APRA's proposed approach to executive remuneration,[43] and its support for the implementation of the Capability Review recommendation around building CBA-style cultural/governance prudential inquiries into its normal supervision activities, are some examples of this.

Improving cyber resilience across the financial system has also been flagged as a key priority for the regulator following the release of its information security prudential standard[44], and in line with the findings of the Capability Review.

From an industry specific perspective, APRA has flagged the superannuation sector, and more particularly improving member outcomes, as a key focus area.[45]

Finally, implementing the recommendations of the Financial Services Royal Commission and the Capability Review (which have implications for all APRA-regulated entities) will remain priorities for the regulator through to 2020 and beyond.[46]

3.6 Financial reporting

3.6.1 Australian Financial Reporting Framework

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Director Technical Standards
Pitcher Partners

The Australian Accounting Standards Board (AASB) is proposing to introduce two main changes to the Australian Financial Reporting Framework (Australian Framework), impacting special purpose financial reports, within the next 12 months. Directors need to be aware of these changes as they are responsible for approval of the financial statements that identify the type of financial report adopted by the entity and contain the required disclosures in accordance with the relevant accounting standards.

The first change will impact those entities preparing special purpose financial reports in accordance with the *Corporations Act 2001* or the *Australian Charities and Not-for-profits Commission Act 2012* for years ending 30 June 2020. The proposals are contained in AASB Exposure Draft 293 *Amendments to Australian Accounting Standards – Disclosure in Special Purpose Financial Statements of Compliance with Recognition and Measurement Requirements.*[47] The proposals require additional disclosures to be made in special purpose financial statements, which will include an explicit statement as to whether or not the accounting policies applied in the financial statements comply with all the recognition and measurement requirements of Australian

[42] MinterEllison, 2019, *"APRA's new enforcement approach: details released"*, 17 April, https://www.minterellison.com/articles/summary-apra-strategic-enforcement-review-final-report-and-enforcement-approach-april-2019, (accessed 28 August 2019).

[43] Australian Prudential Regulation Authority, 2019, *APRA proposes stronger requirements on remuneration to enhance conduct, risk management and accountability*, [media release], 23 July, https://www.apra.gov.au/media-centre/media-releases/apra-proposes-stronger-requirements-remuneration-enhance-conduct-risk, (accessed 28 August 2019).

[44] Australian Prudential Regulation Authority, 2019, *Prudential Standard CPS 234 Information Security*, July, https://www.apra.gov.au/sites/default/files/cps_234_july_2019_for_public_release.pdf, (accessed 28 August 2019).

[45] House of Representatives, op cit.

[46] Australian Prudential Regulation Authority, *"APRA's responses to Royal Commission recommendations"*, https://www.apra.gov.au/apras-responses-royal-commission-recommendations, (Accessed 28 August 2019).

[47] Australian Accounting Standards Board, 2019, *Amendments to Australian Accounting Standards – Disclosure in Special Purpose Financial Statements of Compliance with Recognition and Measurement Requirements, AASB Exposure Draft 293*, July, https://www.aasb.gov.au/admin/file/content105/c9/ACCED293_07-19.pdf, (accessed 28 August 2019).

Accounting Standards (AAS) and, if not, an indication of where they do not comply.

The proposals outlined above are regarded by the AASB as an interim measure until the ability to lodge and prepare special purpose financial reports in accordance with AAS is removed from the Australian Framework. The AASB are working on this removal in phased approach. Phase 1 has already been issued, is effective for annual reporting periods commencing on or after 1 January 2020 and impacts for-profit private sector entities that have public accountability. These entities will need to apply the revised Conceptual Framework that removes the ability for entities to prepare special purpose financial statements.

Phase 2 will be issued shortly and is likely to be effective for annual reporting periods commencing on or after 1 July 2020. It will impact all other for-profit private sector entities, removing the ability for these entities to prepare special purpose financial statements. The impact on these entities will be lessened somewhat due to the increased financial reporting thresholds applying from 1 July 2019 for proprietary companies.

Accompanying Phase 2 will be a new Tier 2 reporting framework which will replace the current Reduced Reporting Regime used by both for-profits and not-for-profit entities with a similar reduced disclosure model called 'Simplified Disclosures'. The proposals for this new model are outlined in AASB Exposure Draft 295 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* open for comment until 15 November 2019.[48]

Directors should be questioning the finance team about the appropriate type of financial statements required for their entity, and their assessment of the impact to the organisation of the impending changes.

3.6.2 Audit quality

Kylee Byrne GAICD
Executive Director
Pitcher Partners

Directors are primarily responsible for the quality of the financial report. Audit quality supports financial reporting quality and ASIC advises in its annual surveillance media release on the latest audit inspection findings[49] that it is in the interests of directors and audit committees to support the audit process.[50]

Audit quality has been a concern of regulators globally and in Australia for some time. Recently, several reviews have been undertaken in the UK that could have important ramifications for Australia, including the Kingman review on the UK regulation of audit, the UK Competition and Markets Authority report on its statutory audit services market study, the UK Parliament Business, Energy and Industrial Strategy Committee report on the future of audit and the review by Sir Donald Brydon into the quality and effectiveness of audit.

In Australia, Parliament has referred an inquiry into the regulation of auditing to the Parliamentary Joint Committee on Corporations and Financial Services, to be reported on by 1 March 2020. This inquiry is wide-reaching,

[48] Australian Accounting Standards Board, 2019, *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities, AASB Exposure Draft 295*, August, https://www.aasb.gov.au/admin/file/content105/c9/ACCED295_08-19.pdf, (accessed 28 August 2019).

[49] Australian Securities and Investments Commission, 2019, *19-013MR Audit inspection findings for 2017-18*, [media release], 24 January, https://asic.gov.au/about-asic/news-centre/find-a-media-release/2019-releases/19-013mr-audit-inspection-findings-for-2017-18/, (accessed 28 August 2019).

[50] If an audit provides non-audit services, section 300(11B) of the *Corporations Act 2001* requires directors of listed entities to make a statement in their directors' report of the reasons that they are satisfied that the provision of non-audit services during the year by the auditor did not compromise the auditor independence requirements. Directors should remind themselves of this obligation and ensure that board and audit committee procedures are sufficiently robust.

covering such areas as the relationship between audit and non-audit services and potential conflicts of interest, the level of competition in the audit profession, audit quality and the effectiveness of audit in detecting and reporting fraud and misconduct, changes in the role of audit and the scope of audit products, effectiveness and appropriateness of legislation, regulation and licensing and the adequacy and performance of regulatory, standards, disciplinary and other bodies.

Directors can contribute to this process either directly through the Parliamentary Joint Committee processes or indirectly through challenging their auditors and promoting audit quality. ASIC has guidance for directors to assist in this process covering areas such as audit appointment, assessing potential and continuing auditors, facilitating the audit process, communicating with the auditor, maintaining auditor independence and assessing audit quality.[51]

3.6.3 Revenue standards for the not-for-profit sector

Kerry Hicks GAICD
Director Technical Standards
Pitcher Partners

Two new revenue standards are applicable for not-for-profit entities for annual periods commencing on or after 1 January 2019: AASB 15 *Revenue from contracts with customers*[52] and AASB 1058 *Income of not-for-profit entities*[53]. Both these standards together will bring about some substantial changes to the way revenue is recognised and disclosed in the financial statements.

The most significant changes are within AASB 15 which will apply when the not-for-profit has enforceable contracts with sufficiently specific performance obligations. Revenue will be recognised as performance obligations are satisfied. This approach should result in better matching of income and related expenses as income recognition will be deferred until the performance obligation is met. This will involve an extensive review of all contracts to determine the impact, and a change in ongoing processes to recognise revenue.

When AASB 15 does not apply to the transaction, the not-for-profit will need to determine whether AASB 1058 applies. AASB 1058 applies to:

- transactions where the consideration paid is significant less than fair value; and
- the discount is to further the not-for-profit objectives.

Typically, this will cover general government grants, capital grants, unconditional donations, gifts volunteer services, and below market lease arrangements.

The AASB has provided a temporary reprieve for holders of peppercorn lease arrangements where the right to use the asset is significantly less than the fair value. The not-for-profit entity will not be required to fair value the arrangement and record it as an asset. Instead the entity will have a choice to either fair value the arrangement or record it at cost with additional disclosures.

The implementation of these two standards should not be under-estimated, and together with the new leasing standard will mean that not-for-profits will have a significant implementation exercise ahead of them.

[51] Australian Securities and Investments Commission, *Audit quality - The role of directors and audit committees, INFO 196*, https://asic.gov.au/regulatory-resources/financial-reporting-and-audit/auditors/audit-quality-the-role-of-directors-and-audit-committees/, (accessed 28 August 2019).

[52] Australian Accounting Standards Board, 2019, *Revenue from contracts with customers, Compiled AASB Standard 15*, 3 January, https://www.aasb.gov.au/admin/file/content105/c9/AASB15_12-14_COMPsep18_01-19.pdf, (accessed 28 August 2019).

[53] Australian Accounting Standards Board, 2019, *Income of not-for-profit entities, Compiled AASB Standard 1058*, 30 May, https://www.aasb.gov.au/admin/file/content105/c9/AASB1058_12-16_COMPdec18_01-19.pdf, (accessed 28 August 2019).

Directors should be questioning their finance teams on the impact of these new standards: What is the impact on the balance sheet and the profit or loss? What conversations or disclosures can we make to our stakeholders – such as donors, financiers, grant providers, members, etc.?

3.6.4 Leases

Kerry Hicks GAICD
Director Technical Standards
Pitcher Partners

The new accounting standard AASB 16 *Leases*[54] applies to annual reporting periods commencing on or after 1 January 2019 to all entities required to prepare accounts in accordance with Australian Accounting Standards. It will affect entities that take out operating leases – such as leasing buildings, transport equipment (including cars), heavy plant and computer equipment.

The standard removes the lessee distinction of operating and finance leases and introduces instead a single lease accounting model. This model will bring most leases onto the balance sheet and will potentially have a significant impact on the profit or loss and balance sheet disclosures.

The commercial and business considerations that will need to be considered include:

- the expense profile of what were operating leases will change, from a straight-line approach to a finance approach with more expense recognised in the early years of a lease;
- the Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA) measure could significantly improve with what were operating lease charges now being reflected as interest and amortisation expenses. This may lead to issues if remuneration arrangements or other performance measures are linked to this measure; and the changes in the balance sheet will see increases in non-current assets, being the right of use of the asset and increases in both current and non-current liabilities, being the lease liability. Such increases and mismatch between current and non-current could impact working capital ratios, debt ratios, bank covenants and regulatory net tangible asset requirements.

Implementation plans should already be in place and should include the collation and assessment of all lease data, identification of the required system, process or internal control changes, assessment of the commercial and business impacts and disclosures in current financial reports. Depending on the number of leases an entity holds this could potentially be a very substantial compliance project.

Directors should be questioning the finance team about the implement progress: What is the impact on the balance sheet and the profit or loss? What communication should we be making to our stakeholders – such as investors, financiers and shareholders?

[54] Australian Accounting Standards Board, 2019, *Leases, Compiled AASB Standard 16*, 29 March, https://www.aasb.gov.au/admin/file/content105/c9/AASB16_02-16_COMPdec18_01-20.pdf, (accessed 28 August 2019).

3.7 Australian Charities and Not-for-profit Commission

3.7.1 Regulatory priorities and risk areas

The Hon Dr Gary Johns
Commissioner
Australian Charities and Not-for-profits Commission

As the national regulator of charities, the Australian Charities and Not-for-profits Commission (ACNC) has responsibility for the regulation of more than 57,000 registered charities. The ACNC registers eligible charities, helps them to understand and meet their obligations, and works to reduce unnecessary regulatory obligations.

The ACNC also provides support to donors and members of the public by maintaining the ACNC Charity Register, a free searchable database containing information on Australia's registered charities, and hearing concerns from the public about the activities and conduct of charities.

The *Charity Compliance Report 2018*[55] found that the ACNC received more than 1,800 concerns in 2018, with 57 per cent raised by members of the public. This activity resulted in more than 170 investigations. 90 investigations were finalised in 2018, resulting in 16 revocations, 24 Compliance Agreements, two Enforceable Undertakings and three Directions.

In 2019 and beyond, the ACNC will continue its focus on reviewing concerns raised to identify charities at risk of misuse. Compliance priorities for 2019 include fraud and financial mismanagement, terrorism, failure to safeguard people and political or unlawful activities.

From July 2019, charities that operate overseas are required to meet the External Conduct Standards.[56] The External Conduct Standards are a set of standards that govern how a registered charity must manage its activities and resources outside Australia.

In addition to these regulatory focuses, charities will soon be able to report on their activities more accurately. From 2020, charities completing their Annual Information Statement (AIS) will be asked to describe their work on a program level, highlighting who they assist and where they operate – terminology which is common across the charity sector. The additional information will improve the results on the ACNC Charity Register, providing richer and more valuable information to charities and donors alike.

3.7.2 Australian Charities and Not-for-profits Commission review

Christie McGrath
Senior Policy Advisor
Australian Institute of Company Directors

In August 2018, an independent panel published the results of its statutory review of the Australian Charities and Not-for-profits Commission (ACNC).

As yet, the Federal Government has not responded to the findings of the ACNC review, but Senator Zed Seselja (Assistant Minister for Finance, Charities and Electoral Matters, with oversight of ACNC) has confirmed that the government is developing a response.

[55] Australian Charities and Not-for-profit Commission, 2019, *Charity Compliance Report 2018*, https://www.acnc.gov.au/tools/reports/compliance-report, (accessed 13 August 2019).

[56] Australian Charities and Not-for-profit Commission, *ACNC External Conducts Standards*, https://www.acnc.gov.au/for-charities/manage-your-charity/charity-governance/acnc-external-conduct-standards, (accessed 13 August 2019).

The review affirmed the broad support for the ACNC among charities and its recommendations generally suggest only minor refinements to the regulatory framework rather than wholesale changes. Notably, the review did not recommend an amendment to the objects or functions of the ACNC, despite this being requested by the new ACNC Commissioner, the Hon. Dr Gary Johns.

Key recommendations of the review included:

- removing the power of the ACNC Commissioner to dismiss directors;
- significantly raising the reporting thresholds to less than $1 million for small charities, from $1 million to less than $5 million for medium charities and $5 million or more for large charities;
- reviewing the ACNC's secrecy provisions to enable the ACNC Commissioner to disclose greater information about their regulatory activity and even investigations;
- bringing certain tax-exempt not-for-profits that are not registered charities under the ACNC regulatory framework; and
- removing, subject to certain preconditions, the exemptions granted to basic religious charities.

One of the more notable recommendations of the review concerns the application of directors' duties for people who are directors of charities.

Under the ACNC's governance standards, charities are required to take reasonable steps to ensure that their directors are subject to and comply with a set of directors' duties modelled on those in the *Corporations Act 2001* (Cth) (Corporations Act). It was intended that the governance standards would replace directors' duties for these directors by turning off ss 180-183 and 191 of the Corporations Act.

However, the review observed that there was some uncertainty about whether and how this applied, and the panel recommended that the duties for directors of charities under the Corporations Act be turned *on* to resolve any uncertainty, at least until a referral of powers could be negotiated to resolve the issue.

The AICD sees the merits in turning back on the statutory duties and is continuing to engage with the government, on this, and other, governance-related recommendations.

The review also recommended the adoption of the #fixfundraising campaign's recommendations to improve the regulation of fundraising. It recommended that the Australian Consumer Law be amended to ensure its broad and clear application to fundraising, that state and territory regulatory regimes be repealed or amended, and that a mandatory code of conduct for fundraisers be developed.

In addition to the ACNC review, the Senate Select Committee on Charity Fundraising in the 21st Century published its report in February 2019 recommending that the government urgently provide a public response to the ACNC review and commit to working with state and territory governments and the not-for-profit sector to develop a consistent national model for regulating not-for-profit and charitable fundraising activities.

The AICD has been an active participant in the #fixfundraising campaign and has welcomed this recommendation by the review.

4. Key boardroom questions to ask in 2020

Graham Bradley AM FAICD
Essential Director Update 2019
Australian Institute of Company Directors

1. Is our desired culture clearly articulated?
2. Do we have effective measures of culture?
3. Have we reviewed incentive compensation?
4. Is our regulatory compliance in good order?
5. Do we need more oversight of non-financial risks?
6. Do we have effective and compliant whistleblower policies?
7. Is our D&O policy effective?
8. Do we do we need to rethink our social purpose?

About us

The Australian Institute of Company Directors (AICD) is committed to strengthening society through world-class governance. We aim to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. Our membership of more than 44,000 includes directors and senior leaders from business, government and the not-for-profit (NFP) sectors.

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