

Boardroom Questions

4th Edition ASX Corporate Governance Principles & Recommendations (4th Edition)



Why Boards need to consider and address the 4th Edition changes now



4th Edition
effective for years
starting on or after
1 January 2020

Process review & change

4th edition focuses on emerging issues around culture, values & trust (Hayne Commission findings). Boards need to assess current policies, processes, controls and reporting in these areas, remediate before the effective date, and then report on that action or why it has not been taken.

Board verification

Boards now required to determine their 'periodic corporate reports' and explain how they have 'verified' the 'accuracy and balance' of the content, where it has not been subject to external audit / review. Work is required before the effective date to confirm, test and document the Board verification approach.

Public trust in Australian corporates was at an all time low in 2018, and has only marginally improved in 2019¹. The ASX Corporate Governance Principles & Recommendations (ASX CGP&R) represent what is considered to be contemporary best corporate governance practice by key stakeholders involved in the capital markets and business reporting – investors, corporations, standard setters, regulators, and relevant professions – who make up the ASX Corporate Governance Council.

The 4th edition changes respond to contemporary governance issues, including those identified in the CBA APRA report and the Hayne Royal Commission. The changes will be a catalyst for organisations to rethink their corporate governance framework and especially their corporate reporting, to proactively respond to such issues, enhance transparency and re-build corporate trust through better meeting the expectations of investors and other key stakeholders, such as customers, employees, regulators and communities.

There is growing global momentum to adopt the International Integrated Reporting Council's International Integrated Reporting <IR> Framework as the corporate reporting norm for investors, financiers and other key stakeholders. This publication highlights the new Recommendation 4.3 in the 4th Edition. The <IR> Framework is the only reporting framework referenced in the 4th Edition for consideration by Boards as a framework they can use to better explain how they are creating sustainable value.

¹ Source: *Edelman Trust Barometer 2019*

Why businesses need to start work now to understand and respond to the 4th Edition changes



The 4th edition was released on 27 February 2019 for 1 January 2020 adoption. Many of the changes in it require a review and assessment of current policies, processes, systems and practices relating to value drivers and risks other than short term financial ones, including innovation, intellectual property, technology, employee strategic alignment, and customer engagement and satisfaction. These areas tend not to be as mature as those relating to financial information. So work should start in 2019 to ensure organisations are in a position to report their adoption of 4th Edition Recommendations by the start of their effective year.

The 'if not, why not' approach continues in the 4th Edition, and so compliance with the recommendations is voluntary. However, disclosure of the reasons for non-adoption is mandatory. There are limited reasons for departure which would be acceptable in the eyes of investors and other key stakeholders. Some entities' corporate governance statements have remained boilerplate. The 4th Edition changes offer an opportunity to introduce a concise and meaningful summary of how the Board applies active governance to drive the required changes - ie; by reporting what the organisation has or has not done in relation to each Principle and Recommendation.

Potential impacts, risks and opportunities



- 1 Investor backlash** – if there is a lack of disclosure and meaningful action to address the new Recommendation It is to better to explain strategy, risk, performance, remuneration and the creation of sustainable value in corporate reports, especially from industry funds / responsible investors.
- 2 Reputation and brand damage** – if controls over and systems used to manage and report on key value drivers/risks other than short term financial ones in the 4th Edition) are not robust, resulting in data errors/gaps, unbalanced reporting and potentially
- 3 Regulatory changes/added burden** - if improvements are not made to business practices to better identify and manage these underlying business value drivers/risks, including transparent and balanced reporting. We are already seeing increased regulatory reporting required on specific business issues (ie; TCFD (climate change), tax.)
- 4 Customers** – it is expected that all organisations, not financial institutions, are taking action to ensure receive products/services they need at a fair price excellent service channels. Progress and performance needs to be captured and reported to realise the benefits.
- 5 Leadership and staff alignment** – will be critical to that there is a consistent understanding of the of systematically managing all key value drivers, working in line with the organisation's purpose values cultural ethos.
- 6 The benefits and costs** – a review of current practices in areas highlighted by the 4th Edition will deliver business and market benefits if the focus remains on what is material to the business and its stakeholders. Non-activities, including corporate reporting, can be halted or refined, with resources reapplied to the effective use of resources to deliver value over the longer term.

Boardroom Questions



- 1** Have we got a program underway to review the 4th changes to identify areas where we need to design and build new policies, practices or enhance current ones before our effective date?
- 2** In relation to Recommendation 4.3, have we revisited company's reporting strategy to remove duplication and define our required go-forward periodic corporate
- 3** Have we considered adoption of the IIRC's International Integrated Reporting < IR> Framework in preparation of annual report, especially the Operating & Financial (Recommendation 4.3)?
- 4** Have we developed and reviewed a Board Verification Matrix to ensure we are comfortable with the level of internal or external checks on all material disclosures in our periodic corporate reports? Is it investment grade? (Recommendation 4.3)
- 5** Have internal Board/management reporting systems updated to ensure that performance of all key value and risks are being effectively monitored and issues quickly escalated?
- 6** Has the executive team engaged with staff on the impact the proposed 4th Edition changes and how the changes are being embedded into policies, practices and accountabilities?

Actions for Boards to consider



- 1** Sponsor a program of work (**readiness review**) to assess organisation's current practices in managing and reporting the 4th Edition issues, so that remediation actions can be taken prior to the **effective start date (1 Jan 2020 - for reporters)**
- 2** Establish a team to review the **current reporting strategy** determine the organisation's periodic corporate reporting portfolio and benchmark the quality of what is reported on ensure good practice (< IR> Framework) and identify opportunities to remove duplication/immaterial disclosures.
- 3** Establish a team, including internal/external audit, to a comprehensive **Board Verification Matrix**, identifying which line of defence is being relied on to ensure the accuracy and balance of all disclosures. Sponsor additional work, where required, to enhance the credibility of key disclosures. (Recommendation 4.3)
- 4** Re-visit the **stakeholder engagement process** to ensure that their reasonable information needs are addressed in the periodic corporate reporting portfolio.
- 5** Ensure there is **alignment between internal Board and management reporting** and what is reported Ensure issues are escalated promptly relating to the edition focus areas (value drivers and risks other than short term financial ones) - Recommendation 4.3.
- 6** **Ensure staff at all levels understand** their roles in embedding the required 4th Edition changes into and procedures and in managing all value drivers and risks day to day to deliver value in the short, medium long term.

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