

# *New ASX Corporate Governance Principles echo recommendations by Commissioner Hayne*

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## *In brief*

On 27 March 2019, the ASX Corporate Governance Council (the **Council**) released the Fourth Edition of its Corporate Governance Principles and Recommendations (**Fourth Edition**).

The Fourth Edition sets out the finalised principles and recommendations following feedback on the consultation draft released in May 2018. The changes demonstrate an overarching commitment to improve corporate governance practices and organisational culture by establishing a firmer framework for practical compliance.

## *In detail – Key changes*

### ***Responds to current social climate***

The Fourth Edition broadly attempts to address issues gaining momentum in the wake of the findings of the Royal Commission, including the sharp decline in trust extended to corporations and a perceived lack of ethical corporate culture and integrity.

The Foreword to the Fourth Edition specifically notes that recent examples of conduct by some listed entities falling short of community standards and expectations highlighted the need for revised Principles and Recommendations to address emerging issues around culture, values and trust.

In this respect, the Fourth Edition certainly succeeds as it introduces a more accessible and practically robust framework for compliance when it comes to typically evasive concepts such as ethics and cultural values.

### ***Removes ‘social licence to operate’***

The change that has generated the most discussion is the removal of all references to ‘social licence to operate’ and its replacement with terms such as ‘reputation’ and ‘standing in the community’.

Whilst it has been suggested that this change might signal a back down from the actual principle, the Council has made it clear that this is not the case but rather, the amendment is intended to clarify what is meant by ‘social licence’ and how it is actually measured in practice so that it is more likely to be understood and applied by listed entities and their boards.

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In highlighting the Council's ongoing commitment to the spirit of social licence, Council chairwoman Elizabeth Johnstone also pointed to the addition of provisions that emphasise culture, values, board diversity, climate change reporting and whistle-blower protections, all of which should address longstanding criticism of the contentious phrase.

Beyond the distraction caused by the phrase itself, the Council also noted that it was concerned that the concept could create problems for companies in gaming, alcohol, tobacco, fast food and mining sectors. For some stakeholders, the prevailing view is that players in these sectors do not have a 'social licence to operate', which demonstrates the subjective and elastic nature of the term and further explains its removal.

### ***Improves reporting, risk management and management oversight***

The Fourth Edition articulates key items that should be addressed in a Board charter and the recommended roles and composition of Board committees such as remuneration, risk and audit committees.

It emphasises the importance of the Board setting the tone from the top by 'defining the entity's purpose', 'approving the entity's statement of values and code of conduct', and actively supervising actions taken by 'overseeing management in its implementation of the entity's strategic objectives and instilling of the entity's values'.

In keeping with Commissioner Hayne's recommendations, the changes also call for greater transparency between Boards and management through improved reporting practices and demand a higher standard of supervisory care from the Board when it comes to ensuring that the entity has an appropriate risk management framework (for both financial and non-financial risks).

One new recommendation also provides that, whenever required, the Board should challenge management and hold it to account.

### ***Other changes***

Other key changes in the Fourth Edition include:

- **Firmer and measurable gender diversity targets:** it is recommended that Boards set measurable objectives for achieving gender diversity not only in the composition of the Board but also in senior executive positions and the workforce more broadly. A specific target has been set for ASX300 listed entities to have a Board composed of at least 30 per cent female directors.
- **Broader diversity targets:** it is recommended that Board composition be diverse in relation to aspects beyond gender, such as cultural and geographic diversity.
- **Clearer guidance on social risk and climate change:** it is recommended that risk management frameworks factor in broader long-term risks such as social, digital, environmental and climate change risks. In particular, it is now suggested that entities with material exposure to climate change risk consider implementing the recommendations of the G20 Financial Stability Board Task Force.
- **Increased emphasis on director's knowledge:** the principles now make it clear that the Board should collectively have the skills, commitment and knowledge of the entity and its industry in order to function effectively.
- **Core values defined and measured for all stakeholders:** the Board is now expected to articulate and disclose the organisation's values and in doing so the Board and management of listed entities must consider the interests of stakeholders beyond shareholders such as their employees, customers, suppliers, creditors, regulators, consumers and local communities in which they operate.

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## ***The takeaway***

The changes in the Fourth Edition are designed to encourage listed entities to commit to improving the culture and values of their organisation by clearly articulating the principles and policies they adopt and remaining accountable to all stakeholders by monitoring and reporting on the organisation's performance against each standard.

It is now clear that Boards are expected to actively supervise and challenge actions taken by management and to ensure that effective frameworks exist within the organisation for risk management and the sharing of information.

The adoption of the principles remains optional, although ASX-listed companies that do not comply are asked to explain to shareholders why they have elected not to comply, on an 'if not, why not' basis.

The Fourth Edition will be effective for listed entities' first full financial year commencing after January 2020.

## ***Let's talk***

For a deeper discussion of how these issues might affect your business, please contact:

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