AUSTRALIAN INSTITUTE
of COMPANY DIRECTORS

The Essential Director Update: 14

Directing tomorrow today

Information you need to know for governing in an ever changing environment

Company Directors Conference Directorship:15

Pre-register today

Held from 20 - 23 May 2015 at the Mandarin Oriental in Kuala Lumpur, Malaysia the Company Directors Conference will challenge you with insights from Australian and International thought leaders. Pre-registrants will have priority in early forum selection.

To pre-register or for enquiries contact Jess Murray
t: 02 8248 2756 **e:** jmurray@companydirectors.com.au

Directing Growth Program

Break through the mid-size growth barrier

A program for owners and directors of mid-size companies

This new one year blended learning program brings together the latest thinking, industry experts and a community of like-minded owners and directors of mid-size businesses.

Join the program t: 1300 123 456
w: companydirectors.com.au/directinggrowth

Mastering the Boardroom

Developing mastery in directorship

Mastering the Boardroom is an experiential professional development program designed especially for the practising director. As one of Company Directors most challenging programs, Mastering the Boardroom requires you to navigate the issues faced by a simulated board operating years into the future.

14 - 17 October 2014 – Victoria
20 - 23 January 2015 – New South Wales
16 - 19 May 2015 – Kuala Lumpur
28 - 31 July 2015 – Queensland
13 - 16 October 2015 – Victoria

For more information and other dates visit
w: companydirectors.com.au/MTB

CONTENTS

THE ESSENTIAL DIRECTOR UPDATE

Welcome and thank you!

We believe there are many essential developments that directors need to be aware of. We also know that each and every one of our members who attends *The Essential Director Update* recognises this and just how important it is to stay up-to-date.

In my final welcome to *The Essential Director Update* as outgoing CEO of Company Directors, it is my great pleasure to thank you for attending this seminar, whether you are here for the first, the third or even the seventh time!

Given the constant and ever increasing rate of change that we hear about so frequently, we, along with many others in our membership community, strive to share our informed thinking on recent developments and outline some of the contemporary issues that we all need to consider.

As we are all individually focused on some niche areas, and thinking about the 'bigger picture' issues that are most important to us, it is also essential that we take a moment to appreciate the value of being part of a director knowledge ecosystem. I encourage you to share one essential update of your own with those you speak with at this forum, and of course, listen to 'what's new' for your peers.

We greatly appreciate your active participation in our activities, which are focused on enhancing the quality of governance and organisational performance for a better economy and society.

I am sorry I will not be with you at all of our events around Australia, but I do hope to see many of you in the future, and rest assured, I will be cheering everyone on from the sidelines after my tenure comes to an end.

Thank you all for your loyalty and support of the Australian Institute of Company Directors.

John H C Colvin FAICD

CEO and Managing Director
Australian Institute of Company Directors

INTRODUCTION

The directors' world is one of constant and rapid change, and this Update covers a range of developments of particular interest.

We have seen market conditions which are more conducive to the transition of businesses to listed status, an increase in merger and acquisition activity, further involvement of private equity and opportunistic plays by major investors during times of corporate change. Each of these place challenges on directors to keep the long-term future and sustainability of their businesses in mind, with many forces focused on short-term issues and performance.

Although the election of a new Federal Government has seen some stabilising of the legislative framework facing directors, the make-up of the Senate means that the future of some key election promises and budget measures remains in doubt. Further, at the State and Territory level, there have been elections or elections are imminent — which can give rise to some level of uncertainty.

This Update examines issues giving rise to public debate in recent times, recent legal developments relevant to directors and the entities they govern and discusses some sector specific developments.

Some consistent themes have emerged regardless of the sector in which directors operate. Transparency of communication, high standards of ethical conduct and clear strategic direction are all highly valued attributes of high performing organisations and directors have a central role in setting the values compass by which their organisations will be assessed.

THE BUSINESS ENVIRONMENT

Merger and acquisition activity

After a number of years of little activity in the M&A landscape and few successful stock market floats, recent times have seen an upturn in this arena, with the press noting that, in 2014, there are clear signs that directors are shedding their risk-aversion in favour of deals.[1] The first half 2014 *Director Sentiment Index* released by Company Directors also found that more than 70 per cent of directors expect a rise in mergers and acquisitions over the next 12 months. The Australian Securities Exchange (ASX) reported 22 floats in the two months of May and June 2014.[2]

A high profile example is David Jones which, after rejecting an approach for a merger from rival retailer Myer, was subject to a board-recommended bid from South African retailer, Woolworths.

The progress of the takeover has not been smooth however, with interests associated with Solomon Lew acquiring a significant stake in the retailer, leading to the postponement of a shareholder meeting to consider Woolworths' proposal. That led to a deal between Lew and Woolworths under which Woolworths proposed to buy Lew's minority shareholding in Country Road, and an unsuccessful late intervention by the Australian Securities and Investments Commission (ASIC) seeking an independent valuation of the 'collateral benefit' it asserted might be received by Mr Lew under the takeover.[3] At a general meeting held in July 2014, David Jones' shareholders voted in favour of the takeover by an overwhelming majority[4] and the court approved the bid without formal opposition from ASIC.

Other major transactions over the last year have included:

- Battle for control of Warrnambool Cheese and Butter between Saputo, Bega Cheese and Murray Goulburn.
- Government-rejected takeover of Graincorp by Archer Daniels Midland.
- Nine Entertainment's float and hedge funds sell-down.
- Federal Government's planned sale of assets, including Medibank Private.
- Contested bid for Goodman Fielder.

[1] http://www.afr.com/p/markets/eofy/finds_legs_as_directors_get_over_mKUAf6GYZo3soRJn1sfjIL

[2] http://www.asx.com.au/asx/research/recentFloats.do

[3] http://www.smh.com.au/business/retail/asic-steps-into-david-jones-country-road-battles-with-demand-for-independent-valuation-20140702-zstnq.html

[4] http://www.davidjones.com.au/-/media/Files/Corporate/ASX%20and%20Media/2014/20140714Scheme%20Meeting%20Results%20Announcement.ashx

- Private equity bid for standards publisher SAI Global with internal turmoil and exit of CEO and potential competition for the $1.1 billion bid.
- Spotless float after 2 years in private equity ownership.
- Family-owned GM Scott, a leading lamb and cattle business, sold to Manildra Group.
- Craig Moyston, a leading food and agribusiness based in Western Australia, bought Australia's biggest abalone farm Great Southern Waters, outbidding Chinese investors to grab the Asian-focused business.
- Andrew Forrest, the man behind Fortescue Metals Group, bought Western Australia's biggest beef abattoir Harvey Beef together with some Chinese investors earlier this year.

Director sentiment index

The latest Director Sentiment Index was released in May 2014.
The key findings were:

- Overall director sentiment has fallen 6.9 points since the last survey, although sentiment is slightly higher than at the same time last year.
- Less than 30 per cent of directors believe the Federal Government's performance is having a positive impact on both their business decision making and consumer confidence.
- The number of directors who believe the Government understands business has slipped to 48 per cent from 55 per cent previously.
- Directors are more pessimistic about the future health of the Australian economy, with just under half expecting it to be weak over the next 12 months.
- For the first time in the three-year life of the DSI, directors expect the US economy to outperform the domestic economy.
- Directors have indicated that productivity growth is now their biggest economic challenge, followed by issues such as excessive regulation and a lack of spending on infrastructure.
- Directors view significant industrial relations reform as a priority, although 40 per cent hold the opinion that an electoral mandate should first be given.
- 42 per cent of directors say that 'red tape' has increased over the last 12 months, however almost 40 per cent of directors expect a decrease in 'red-tape' in the next 12 months.
- Around 60 per cent of directors agree the NBN is a positive thing for Australia.
- Directors identify general economic conditions as the top impediment to productivity growth in their business, followed by 'red-tape' and workplace relations laws.

For further information, see the Director Sentiment Index.[5]

[5] www.companydirectors.com.au/Director-Resource-Centre/Research-reports/Director-Sentiment-Index.

GOVERNMENT REVIEWS

Two significant reviews are currently underway in the Commonwealth sphere, and directors will need to keep watch on developments, and if appropriate, consider active participation in their activities.

Financial systems inquiry

The Inquiry, chaired by David Murray AO FAICD, will report on the consequences of developments in the Australian financial system since the 1997 Financial System Inquiry and the global financial crisis, including implications for:

- how Australia funds its growth;
- domestic competition and international competitiveness; and
- the current cost, quality, safety and availability of financial services, products and capital for users.

In its submission to the Inquiry (focusing primarily on governance issues in the financial services industry), Company Directors argued that a more flexible system of governance regulation is required for entities regulated by the Australian Prudential Regulation Authority (APRA) and suggested this flexibility could be achieved if there was greater alignment of APRA's regulation with the ASX Corporate Governance Council (ASXCGC) *Corporate Governance Council's Corporate Governance Principles and Recommendations 3rd edition* (the *Principles and Recommendations*), including the 'if not, why not' approach to governance.

Following the initial consultation, the Inquiry released its Interim Report in July.

In particular, it notes:

- To contribute to the effectiveness of the financial system, sound corporate governance requires clarity of the responsibilities and authority of boards and management.
- A board's obligations are: overseeing, directing and monitoring the performance of the company; approving and overseeing strategic policies and frameworks (including risk management); and satisfying itself that such policies and frameworks are effective.
- Substantial regulator focus on boards has confused the delineation between the role of the board and that of management.
- Although there is a public policy case for specific corporate governance requirements on financial institutions, there is no case for regulation to alter the delineation of responsibilities between boards and management.

- The more prescriptive approach to remuneration policy taken in some jurisdictions is unlikely to be appropriate for Australia, where there have been fewer financial failures and remuneration package are more contained than in some other countries.
- Many stakeholders argued that complying with regulation is costly and the pace of change has increased these costs. There is a need to weigh the costs and benefits of new regulation adequately. There is also a lack of time taken for industry consultation or implementation. To help assess the costs and benefits of regulation more generally, the Inquiry has commissioned further work on the burden of regulation from both domestic and international reforms.

The Inquiry is now calling for a second round of submissions to gather further evidence, check the validity of observations and test potential policy options. The final report is expected to be released in November.

In addition to the Financial Systems Inquiry, the Senate Economics References Committee conducted an inquiry into the performance of ASIC. Following the Committee's report, there have been calls for a Royal Commission into issues involved in the Commonwealth Bank's financial planning arm and controversy about the role of regulation of that sector and the role of commissions paid to advisors.[6] The Commonwealth Bank has recently announced changes to its compensation scheme for impacted investors, and although the government has expressed unhappiness with the Commonwealth Bank's response, it has thus far resisted the call for a Royal Commission.

In a speech to Company Directors' members in June 2014, ASIC Chairman, Greg Medcraft said financial advisors and managed investment schemes would be a key risk area for focus by ASIC, although he also pointed out that investors also have individual responsibility for their decisions.

Competition review

Chaired by Ian Harper FAICD, the key areas of focus for this review are to:

- Identify regulations and other impediments across the economy that restrict competition and reduce productivity, which are not in the broader public interest.
- Examine the competition provisions of the *Competition and Consumer Act* 2010 (CCA) to ensure they are driving efficient, competitive and durable outcomes, particularly in light of changes to the Australian economy in recent decades and its increased integration into global markets.
- Examine the competition provisions and the special protections for small business in the CCA to ensure efficient businesses, both big and small, can compete effectively and have incentives to invest and innovate for the future.

[6] See Recommendation 7 of the Senate Economics References Committee Report, *Performance of the Australian Securities and Investments Commission*, June 2014.

- Consider whether the structure and powers of the competition institutions remain appropriate, in light of ongoing changes in the economy and the desire to reduce the regulatory impost on business.
- Review government involvement in markets through government business enterprises, direct ownership of assets and the competitive neutrality policy, with a view to reducing government involvement where there is no longer a clear public interest need.

The first round of submissions to this review included calls for:

- Less government prescription and more industry self-regulation.
- The CCA's performance to be regularly reviewed by the Productivity Commission.
- Less complexity and red tape to support business activity.

The review's Draft Report is currently scheduled for release in late September 2014.

GOVERNANCE LANDSCAPE

ASXCGC Corporate Governance Principles and Recommendations

Following an extensive public consultation that commenced in August 2013, the ASXCGC released the revised 3rd edition of its Principles and Recommendations in early 2014, which come into effect from a listed entity's first financial year commencing on or after 1 July 2014.[7] This means that entities with a 30 June balance date will be expected to report against the revised Principles commencing with the financial year ended 30 June 2015, while entities with a 31 December balance date will report against them commencing with the financial year ended 31 December 2015.

Although only applicable to listed companies, the Principles and Recommendations can form a benchmark for wider adoption as appropriate.

The revised Principles continue to apply to all ASX listed entities on the 'if not, why not' approach they were founded on and which has become internationally recognised as being synonymous with good governance regulation.

Under this approach, if a listed entity considers a recommendation made in the Principles is not appropriate for its particular circumstances, it is entitled not to adopt it and to instead adopt an alternative governance practice more suited to its circumstances. However, if it does this, it must explain why it was appropriate to do so.

Unlike previous editions of the Principles, entities are now provided with greater flexibility to disclose their corporate governance arrangements (including their 'if not, why not' explanations) on their websites rather than in their annual reports. This change should have the effect of reducing the overall length of the entity's annual report.

Some of the new recommendations[8] that listed entities will need to report against under the revised Principles and Recommendations include:

- Recommendation 1.2 (New directors) — A listed entity should undertake appropriate checks before appointing a person, or putting forward a person for election, as a director.
- Recommendation 2.6 (Director induction and professional development) — A listed entity should have a program for inducting new directors and provide appropriate professional development opportunities for directors to develop

[7] ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations 3rd Edition*, available at: www.asx.com.au.

[8] These recommendations either reflect new additions to the Principles or previous commentary that is now a recommendation.

and maintain the skills and knowledge needed to perform their role as directors effectively.

- Recommendation 6.4 (Communications) — A listed entity should give security holders the option to receive communications from, and send communications to, the entity and its security registry electronically.
- Recommendation 7.1 (Risk) — The board of a listed entity should have a committee or committees to oversee risk. However, a board of a listed company may appropriately determine that it does not require a committee to deal with risk, regardless of the company's size, but it will have to disclose that fact and the reason for it, as well as explaining how it is overseeing the entity's risk management framework (this is a new inclusion to the Principles).
- Recommendation 7.3 (Internal audit) — A listed entity should disclose if it has an internal audit function, how the function is structured and what role it performs; or if it does not have an internal audit function, that fact and the processes it employs for evaluating and continually improving the effectiveness of its risk management and internal control processes.
- Recommendation 7.4 (ESG) — A listed entity should disclose whether it has any material exposure to economic, environmental and social sustainability risks and, if it does, how it manages or intends to manage those risks.

Stakeholder relations

The year has seen increasing activism from shareholders and other stakeholders in the affairs of organisations. The regular media reports of the attitudes of key shareholders in the events at David Jones in recent months have been an illustration of this trend, which is being experienced worldwide.[9]

This trend means it is extremely important, particularly for listed companies, to have in place effective communications policies for engaging with shareholders.

Dr Ulysses Chioatto MAICD, an executive director of proxy adviser Institutional Shareholder Services (ISS), believes corporate Australia faces a wave of US-style shareholder activism, evidence of which will be seen during this year's AGM season.[10] An ISS paper, *Shareholder Activism in Australia*, noted:

> **'Historically, activism in Australia took the route of behind-the-scenes private discussions [between investors and the board], but recently there has been an uptick in public battles.'**

Increasing merger and acquisition activity may also see increased shareholder pressure on boards, with shareholders seeking to drive board change at underperforming companies or to force up the bid price.[11]

[9] http://www.issgovernance.com/library/defining-engagement-update-evolving-relationship-shareholders-directors-executives/

[10] Featherstone, T., 2014, *Boards Under Fire*, Company Director magazine, June.

[11] Featherstone, T., 2014, *Boards Under Fire*, Company Director magazine, June.

Board performance and evaluations

As part of the revision of the ASXCGC Principles and Recommendations (see above), the recommendation relating to board, committee and director performance evaluations has been moved from Recommendation 2.5 to Recommendation 1.6. The content, however, remains essentially the same:

A listed entity should:

(a) have and disclose a process for periodically evaluating the performance of the board, its committees and individual directors; and

(b) disclose, in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process.

There have been more significant changes in the guidance provided in the commentary to this recommendation. In particular, the commentary now states 'boards should consider periodically using external facilitators to conduct its performance reviews'. It is considered that the performance evaluation of the chairman should be the responsibility of a suitable non-executive director (such as the deputy chairman or the senior independent director, if the entity has one). It is also suggested, when disclosing whether a performance evaluation has occurred, the listed entity should, where appropriate 'also disclose any insights it has gained from the evaluation and any governance changes it has made as a result'.

In a recent interview for Company Directors magazine, Michael Robinson MAICD of remuneration adviser Guerdon Associates commented he believed institutional investors and proxy advisers will seek more information on board reviews during the next AGM season.[12] He also predicted that over time there would be more expansive board review disclosures, akin to what has happened with remuneration reports.

Recognising the importance of and the increased demand for board reviews, Company Directors has developed the Governance Analysis Tool™, for use in board and broader governance reviews by ASX listed, commercial unlisted, not-for-profit and public sector entities.[13] Based on Company Directors' recent experience with the Tool, issues that have arisen more commonly than others include:

- Dissatisfaction with the quality of information the board receives from management (for example, papers too long, don't focus on right issues, not fit for purpose).
- The lack of a regular and properly structured board review process and the degree to which follow-up has occurred in respect of actions identified in previous board reviews/evaluations.
- Issues relating to board composition (for example diversity of skills and/or experience relative to the organisation's current and anticipated circumstance).[14]

[12] Featherstone, T., 2014, *Boards Under Fire*, Company Director Magazine, June.

[13] http://www.companydirectors.com.au/Director-Resource-Centre/Governance-Analysis-Tool

[14] Source: Aggregated masked data collected from Company Directors' Governance Analysis Tool™, 2013-2014.

Board diversity

During the last year there have been some international changes in regulation to achieve greater board diversity, particularly in relation to gender. The European Commission is considering imposing quotas of 40 per cent for female directors across the EU. Germany has introduced legislation that will require large listed companies to allocate 30 per cent of their non-executive board seats to women. Malaysia has imposed a 30 per cent quota for new appointments to boards and Brazil has imposed a 40 per cent target for state-controlled firms. Whilst there has been some progress in Asian Pacific countries, only Australia has shown advancement across a number of indicators such as a higher percentage of female directors, fewer all-male boards, more boards with multiple female directors, and more female directors holding leadership positions. Countries with legislated quotas, such as Norway and Finland still lead in the number of women on boards.

Included in the updated ASXCGC Principles and Recommendations 3rd edition are the recommendations on diversity (Recommendation 1.5) which have been modified to:

- Allow listed entities that are 'relevant employers' under the *Workplace Gender Equality Agency* 2012 to report their 'Gender Equality Indicators' instead of reporting the respective proportions of men and women on the board, in senior executive positions and across the whole organisation.
- Provide that where a listed entity chooses to report the respective proportions of men and women on the board, in senior executive positions and across the whole organisation, it should disclose how it has defined 'senior executive' for these purposes.
- Provide enhanced commentary on the meaning of 'measurable objectives' and on the steps a listed entity can take to measure its achievements against the diversity objectives it has set.

Some progress has been made in Australia. Statistics kept by Company Directors show the latest percentage of women on ASX 200 boards is 18.2 per cent (28 May 2014), with women comprising 31 per cent of new appointments. There remains room for improvement, as there are still 41 boards in the ASX 200 that do not have any female members at all.

The Federal Government has decided to delay by one year the introduction of additional reporting requirements under the *Workplace Gender Equality Agency Act* 2012 due to be introduced for the 2014 – 2015 reporting period. The Federal Government will make a decision on the next reporting period after consultation with a broad group of stakeholders.

Innovation

Innovation has been frequently discussed across the director community, from many different angles, including:

- Innovation strategies and strategic execution in mature organisations (particularly the question of how to deal with the risk of disruption).
- Considering innovation or 'new thinking' capability as criteria for director selection.
- The role of government in supporting start-ups, early-stage and growing companies.
- Reducing barriers to innovation (eg. regulation and red-tape).
- Improving the competitiveness of Australia as a nation through enhanced innovation capabilities.
- Innovation in the social sector for improved service delivery in the face of funding pressures.

Turning insights into action and impact in all of these areas arguably remains a challenge. One report evidencing the need for ongoing improvement in Australia's collective capability is the 2014 *Global Innovation Index* (GII)[15], where the economy was ranked 17 out of 143 (a slight improvement on Australia's 2013 and 2012 rankings of 19 and 23 respectively).

Perhaps adding to the challenge in the short-term has been structural changes within Government, with Federal responsibility for innovation incorporated into the Department of Industry portfolio established after the 2013 election.

Further, anecdotal evidence suggests some organisations are also yet to step up the maturity scale of their innovation programs. For example, in innovation-mature organisations, there is a culture that supports the sharing and evaluation of a high volume of ideas. Innovative initiatives can be effectively filtered, and the most valuable ideas developed to the point where they can be successfully commercialised (or deliver value to an organisation in the form of cost savings).

> **'… innovation happens not by exception but is integral to all parts of the firm.'**
>
> *Steve Blank, Esade Business School Commencement Speech, March 2014*[16]

Clayton Christensen, an 'expert on innovation and growth' was heralded as the world's top management thinker in 2013 by Thinkers50 — and organisation based on a belief that ideas can change the world and new thinking can create a better future.[17]

[15] The GII seeks to benchmark countries' innovation capabilities through analysis of more than 80 indicators.

[16] http://steveblank.com/2014/03/31/esade-business-school-commencement-speech-2/

[17] http://www.thinkers50.com/

It is possible to foresee boards increasingly seeking out director candidates who bring an innovation mindset. Track record may be assessed not on the basis of past successful approaches to execution, but rather on one's ability to analyse, assess and respond to adaptive challenges in context.

In somewhat of a contrast to Christensen's work on disruption starting with small, unprofitable market segments, Paul Nunes and Larry Downes launched *Big Bang Disruption* in January 2014 highlighting a radical new kind of innovation, where consumers abandon incumbent products rapidly.[18]

Social media and social business

While some organisations are still grappling with maximising the return on investment in social media, others are advocating the 'return on involvement' that comes from operating as a social business.

Social business, in this context, goes beyond the strategic or tactical use of social networks or tools, to a fundamental shift in how a business is designed and operates. A social business is one that truly seeks to connect and collaborate with its customers, employees and suppliers to create, exchange or even transform, value. Social business is about relationships and connectivity. Its value will be measured not by increased awareness, but by changes in perception and increased stakeholder interaction and loyalty.

> **'Companies are starting to derive real value from social business, but this value is concentrated most strongly in companies that have reached a certain level of sophistication in relation to their social business initiatives.'[19]**

Case law

According to Addisons, businesses were provided with a timely reminder of the need to establish and maintain a social media policy following the NSW District Court's decision of Mickle v Farley [2013] NSWDC 295.

The case, which has been reported as the first social media defamation case to proceed to trial, concerned a young former student (Mr Andrew Farley) and a series of defamatory tweets and Facebook posts regarding a teacher (Ms Christine Mickle).

The damages that Mr Farley was ordered to pay to Ms Mickle were in the amount of $85,000. He was also ordered to pay aggravated damages of $20,000 for his conduct during the case.

[18] http://www.forbes.com/sites/bigbangdisruption/2013/05/09/welcome-to-the-world-of-better-and-cheaper/

[19] http://sloanreview.mit.edu/article/finding-the-value-in-social-business/

Boycotts

Social media has been used by activists to call for boycotts on products. Currently, under Section 45D of the *Competition and Consumer Act*, secondary boycotts for the purpose of causing substantial loss or damage are prohibited. It has been reported that the Federal Government is considering repealing an exemption that provides for boycotts of companies on environmental grounds.[20]

Crowd funding

In late 2013, citizens joined together to support Tim Flannery's Climate Council, after the Commonwealth Government-funded Climate Commission was abolished. The Council raised more than $1 million through crowd-funding, which was sufficient to enable it to continue for 12 months.[21]

[20] See Clark, C., 2014, *In the government's hierarchy of values, is free speech at the top?*, The Conversation, April.

[21] http://www.abc.net.au/news/2013-10-05/climate-council-has-sufficient-funding-to-operate-for-a-year/5000822

INFORMATION TECHNOLOGY TRENDS

The rate of change in information technology continues to increase exponentially. Following are just a few of the issues which might be relevant to consider.

Digital transformation

According to an article in *The Economist* in 2013, the Alibaba Group (Alibaba) handled more in online sales than eBay and Amazon combined. Alibaba, perhaps more than any other organisation given its size, epitomises today's rapidly transforming digital world and the power of the marketplace model. As well as being a platform for global trade, Alibaba also operates a payment service provider, Alipay; a news website, Alizila and more.

Alibaba, whose mission is 'to make it easy to do business any way', was founded in 1999 by 18 people. At the time of writing, the Hangzhou, China-based, Alibaba, with its 22,000 employees, had filed to go public in the United States. Upon announcing its intention to IPO, commentators started to speculate it could surpass Facebook with a record valuation.

Back in Australia, online retail service expectations have increased with international digital developments. This was evidenced in the case of Myer, which experienced a lengthy online retail outage after it launched its Boxing Day sales.

> **Myer chief executive Bernie Brooks made the extraordinary statement that resolving the technical difficulties was not as simple as 'running an automatic clean-up process on a personal computer, or turning a device off and on again' … The problem for any competent IT team is … it damn well should have been.**[22]

Data, analytics and the power of information

Delegates at the Company Directors Conference in 2014 heard how companies can innovate by analysing large data sets. Data has been referred to as a resource akin to natural resources that can be extracted, analysed and converted into valuable assets.

Data science is growing as a profession as the amount of data available for analysis also grows exponentially. Australian-founded Kaggle, with its community of 180,000 data scientists, claims to be the world's largest analytics marketplace (an impressive achievement having launched in just 2010).

[22] http://delimiter.com.au/2014/01/08/myer-fail-displays-appalling-business-incompetency/

The company offers to solve problems faced by real-world organisations through encouraging its community members to compete on challenges. For example, GE launched a competition called Flight Quest 2 to crowd source algorithms designed to increased flight efficiencies. 3800 submissions to the contest were received and the first place model prepared by José Fonollosa proved to be up to 12 per cent more efficient when compared to data from actual flights.[23]

Along with a rise in the number of human data scientists, IBM is also discussing the emergence of cognitive computing, which refers to the use of artificial intelligence (AI) and machine learning systems or algorithms to sense, predict, infer and even think through large volumes of data.

While there is debate about some jobs being replaced by technology developments, cognitive computing suggests there is great potential for advancing decision making by combining machine intelligence and human analysis.

Mobile

According to the KPCB 2014 Internet Trends Report released in May, overall internet usage growth is slowing, but mobile data traffic continues to grow.[24] The KPCB also reported there are now 5.2 billion mobile phone users worldwide.

At its developer conference in June, Apple announced there were 1.2 million apps in the Apple App Store, an increase of 300,000 apps on 2013. Apple CEO, Tim Cook, also reported nine million developers have registered with Apple, up 47 per cent, suggesting many more apps to come. The challenge for those developing apps remains getting noticed in the crowded marketplace. Meanwhile, Google Play is also reported as having more than one million apps in its store.

The increase in mobile device usage is also having an impact on consumer expectations, according to Julie Ask of Forrester Research.

> **The expectation that I can get what I want in my immediate context and moments of need … Your company must meet these new expectations.[25]**

In a presentation on '2014 Mobile trends', Ask suggests mobile usage will transform businesses; apps will need to seamlessly intersect with the physical world (eg. retail stores) and companies may also be able to enhance their customer insights through analysing mobile usage data.

Android wristwatches are also set to launch soon, with a raft of watch apps expected to follow, according to Tech Radar's review of the 2014 Google Developer Conference.

[23] http://blog.kaggle.com/2014/04/23/kaggle-newsletter-data-on-a-journey/

[24] Kleiner Perkins Caufield & Byers http://www.kpcb.com/insights/2014-internet-trends

[25] http://www.slideshare.net/forrester/2014-mobile-trends-31583106

In Australia, Telstra remains the market leader of mobile services, with 15.1 million domestic mobile retail customers (up 1.3 million in 2013) and the company is investing in maintaining its network and look to acquire new spectrum licenses to cater for further growth in mobile content traffic.[26]

Cloud computing

Cloud computing offers opportunities for businesses, but there is also a need to understand the potential risks of using cloud-based software, services or applications.

The challenge for directors is to filter through any technical jargon or vendor hype and ask questions that can assist their organisation to unlock value and realise opportunities. There are a number of online glossaries available that define common terms, which may assist those unfamiliar with technology language.

Following the creation of 'APP 8' under the Australian Privacy Principles, the real physical location of 'clouds' is also important to understand to ensure compliance with the laws around cross-border disclosures of personal information.

Further, from a governance perspective, it is also important to have clarity of roles and responsibilities around decision making for cloud services, and to follow appropriate processes. Research suggests much investment in cloud software and services is being driven by marketing departments, as opposed to IT.

Regardless of where a recommendation to adopt cloud services arises from, due diligence may necessitate a thorough contract management and/or legal review process to ensure any risks can be identified or mitigated.

The decision of whether to use, and/or how to govern the associated risks, applies to a wide range of applications, including CRM systems, iPad board papers and accounting packages.

There are many proponents for the cloud, given advantages such as lower costs and outsourced support. Paradoxically, there are also reports of a return to IT on-site solutions, or insourcing. Directors should consider the merits of cloud versus in-house or on-site options and discuss the appropriate mix for their organisations.

Cyber security and resilience

Advisors in the cyber security industry now recommend that businesses prepare for cyber security breaches, as their occurrence has become more likely. Indeed, some argue it is likely an organisation's systems will have already been compromised, and those within the organisation may not even realise it.

[26] http://www.telstra.com.au/abouttelstra/download/document/Telstra-Annual-Report-2013.pdf

A prominent security breach during the year has been that of US-retailer Target and its point of sale systems.[27]

Directors should seek assurance their organisation has in place a strategy to detect, analyse and response to targeted cyber-attacks.

As the use of new technology advances within infrastructure, directors may need to think laterally about potential risk exposures. For example, what security risks may elevator software present to an organisation (note the trend emerging for elevator destination and stopping patterns to be defined outside the elevator rather than within it)?

In the United States, the Government Audit Office reported[28] that twenty-four major federal agencies did not consistently demonstrate that they are effectively responding to cyber incidents.

See also *Trend Micro's TrendLabs* 1Q 2014 Security roundup for further detail on trends in cyber risks.[29]

IT-enabled projects

In December 2013, Standards Australia published a new standard to support governance leaders to guide IT-enabled projects through the use of appropriate governance frameworks and principles. Titled 'AS/NZS 8016', the standard offers a model of engagement between an organisation's governing body (or board) and management. It is also designed to assist board members — who may not have technology backgrounds — to evaluate business cases for major IT-related investment decisions.

3D printing and additive manufacturing

3D printing is a fast-growing market that has reached an inflection point, according to IT research firm, Gartner. The technology referred to by some as additive manufacturing has also been touted as 'the next industrial revolution' for its innovative and disruptive potential. In numeric terms, the compound annual growth rate (CAGR) of worldwide revenues produced by all additive manufacturing products and services for the past three years (2011–2013) has been reported at 32.3 per cent.[30]

---

[27] See *'Missed Alarms and 40 Million Stolen Credit Card Numbers: How Target Blew It'*, Bloomberg BusinessWeek, 13 March 2014. http://www.businessweek.com/articles/2014-03-13/target-missed-alarms-in-epic-hack-of-credit-card-data

[28] http://www.gao.gov/products/GAO-14-354

[29] http://www.trendmicro.com.au/cloud-content/au/pdfs/security-intelligence/reports/rpt-cybercrime-hits-the-unexpected.pdf

[30] http://wohlersassociates.com/blog/

The decreasing costs and the technology's use at scale could influence, transform and/or disrupt organisations across a wide range of industries. These include: waste management, logistics, the arts, education, intellectual property, food, toys, the medical industry and not-for-profit aid bodies.[31]

Robotics

Almost half of all jobs in industrialised nations like Australia are at risk of redundancy over the next two decades because of the increasing uptake of automation technologies and advanced robotics, according to Professor Michael Osborne of Oxford University. It is worth exploring how robotics may increasingly become substitutes for human labour in new fields — and consider the potential implications of this.

Quantified self

The 'quantified self' movement is defined as the increasing use of technology to collect data about oneself. Interest in this area of electronics is increasing as wearable lifestyle tracking devices ('wearables') such as FitBit and Jawbone have become popular purchases.

Apple Computer has announced it will introduce its own health app when its new mobile operating system, iOS 8, is released later this year. It will be accompanied by a developer tool, enabling integration with other health and fitness apps, and also further extend the powerful mobile ecosystem business model.

In an interview in July, Google's founders Sergey Brin and Larry Page, also discussed their company's moves into the health care market.[32]

> **I am really excited about the possibility of data also, to improve health … Imagine you had the ability to search people's medical records in the US.**
>
> *Larry Page, Google*

The first product expected to be made available on the Android platform has been developed by Medisafe from Israel.

Locally, ResMed's chief Mick Farrell announced at a conference in April this year that the company had plans to make products to monitor consumers' health.[33]

While proponents are capitalising on the growth in mobile devices, advances in cloud technology and willingness of consumers to share, privacy and ethics are important governance issues to consider.

[31] http://www.techrepublic.com/article/10-industries-3d-printing-will-disrupt-or-decimate/

[32] http://www.theguardian.com/technology/2014/jul/07/google-founders-larry-page-sergey-brin-interview

[33] http://www.smh.com.au/business/apple-fitbit-in-resmeds-sights-with-quantified-self-gadget-plan-20140401-35w0r.html

The privacy policies of many popular self-tracking apps indicate information generated may be shared with third parties and/or analysed in aggregate. History suggests consumers may unknowingly be sharing the data they generate by using apps without consideration of security or how it may be used at a later date.[34]

In an interesting development, the Respect Network[35] was launched in June, with a proclamation of privacy by design and a promise to enable users to take back control of their personal data. The network seeks to capitalise on consumer concerns about exploitation of information about them.

Australia's place in the digital economy

In early 2014, the Australian-founded software company, Atlassian, moved its headquarters to London. It explained the move on the basis of looking to gain traction with the investment community ahead of a planned IPO. In April 2014, Atlassian was valued at $3.5 billion, which saw the company rise to higher prominence in the local market.

The move also sparked debate around opportunities for technology companies to scale or grow from within Australia. IT sector commentator, Len Rust, says:

> **We need a dedicated commitment with a national strategy on the development of the ICT industry in Australia[36]**

Software by its very nature has made the world smaller and global competition has become more intense. As the use of software grows and new products and services emerge, the market for talent and capital investment is also expected to present both challenges and opportunities for founders and employers.[37]

Highlighting the issues perceived to be impeding growth of tech companies, StartupAUS released the *Crossroads Report* in April, setting out an action plan for the growth and maturation of the Australian start-up ecosystem.[38]

Among the recommended actions were improvements in entrepreneurial education and increased availability of early stage capital in the Australian market.

The strategic impacts of the developments outlined above are worth considering by all organisations, and boards may need to consider whether they need expertise in these areas around the table.

[34] http://pando.com/2013/05/20/you-are-your-data-the-scary-future-of-the-quantified-self-movement/

[35] http://info.respectnetwork.com/

[36] http://www.rustreport.com.au/issues/latestissue/where-to-now-for-australia%e2%80%99s-digital-future/

[37] http://www.forbes.com/sites/joshbersin/2013/12/19/ten-predictions-for-talent-leadership-and-hr-technology-in-2014/

[38] http://startupaus.org/crossroads/

LEGAL AND REGULATORY DEVELOPMENTS

ASIC update

The Federal Budget will cut funding to ASIC by $120.1 million over the next five years, with an initial reduction of $43.9 million, or close to 12 per cent, in appropriation revenue in 2014/2015.[39] Up to 20 per cent of jobs in ASIC will be cut in 2014/2015. This has already commenced with a voluntary redundancy program implemented in advance of the budget, through which 150 jobs have already been cut.[40] The Government has also set aside additional funding to investigate the sale of the ASIC registry.

The performance and functions of ASIC are being closely scrutinised. The Federal Government's National Commission of Audit report, released 1 May 2014, recommended ASIC's registry functions be transferred away from ASIC, its financial literacy functions cease and the consumer protection functions be moved to the Australian Competition and Consumer Commission (ACCC).[41] It considered the overlapping functions of ASIC with those of APRA and the ACCC, should be considered in the context of the Financial Systems Inquiry (see above).

The Federal Senate Economics References Committee also reported on the performance of ASIC in mid-2014, and made a series of recommendations, including that its operations should be funded by industry levies. The Committee said:

> **The good work that ASIC has done in a challenging environment has been recognised. Even so, there is a need for ASIC to become a far more proactive regulator ready to act promptly but fairly. ASIC also needs to be a harsh critic of its own performance with the drive to identify and implement improvements.[42]**

Company Directors provided comments on the Senate inquiry noting, in its view, any deficiencies in ASIC's performance and effectiveness are more likely to be caused by a lack of adequate funding and resources to allow ASIC to fulfil its role

[39] http://www.treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2014/PBS%202014-15/Downloads/PDF/06%20ASIC.ashx

[40] http://www.theaustralian.com.au/business/fear-job-losses-will-hobble-asic/story-e6frg8zx-1226917990852
http://www.smh.com.au/national/public-service/jobs-programs-go-as-asic-looks-to-cut-costs-20140319-3531d.html

[41] http://www.ncoa.gov.au/

[42] http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/ASIC

as a corporate regulator.[43] This has been, at least in part, due to the fact that ASIC's role as a regulator has been increased significantly over time and its resources have been stretched as a result. It was also recognised ASIC is often placed in a difficult position due to the unrealistic expectations of the government, media and general public. There seems to be a general misunderstanding as to what ASIC can reasonably achieve as a regulator.

ASIC Chairman, Greg Medcraft in a June 2014 speech to Company Directors' members said:

In this age of innovation, the key external challenges I see for ASIC are:

- **balancing free markets and investor protection with a particular focus on deregulation**
- **structural change in our financial system through the growth of market-based financing and super;**
- **financial innovation-driven complexity in products, markets and technology, and**
- **gloabalisation.**

He spoke about the key role played by directors as gatekeepers helping to ensure markets work effectively and investors are confident and informed. He said directors' stewardship needs to drive the right compliance culture in their organisations.

Continuous disclosure

Directors of listed entities should be well aware of the obligations of continuous disclosure and the regulator's focus on ensuring fair, orderly and transparent markets. However, the challenges of keeping close to the proxy advisors, institutional shareholders and other stakeholders can give rise to practical risks which directors need to be sure are appropriate identified and managed.[44]

In September 2013, Newcrest Mining was accused of selective briefing to analysts about forthcoming gold production and capital expenditure changes. Newcrest commissioned an independent review of its disclosure practices, which found there had been no breaches by the company of its continuous disclosure obligations. It should be noted this internal review was hampered due to a concurrent ASIC review into the same events which meant its access to some key individuals was limited.

The report did, however, make a series of recommendations to improve processes and governance around these issues.[45]

[43] See Company Directors submission to the Senate Standing Committees on Economics dated 21 October 2013 available at www.companydirectors.com .au (http://www.companydirectors.com.au/Director-Resource-Centre/Policy-on-director-issues/Policy-Submissions/2013/Submission-on-the-performance-of-the-Australian-Securities-and-Investments-Commission)

[44] http://theconversation.com/explainer-continuous-disclosure-obligations-16894

[45] http://www.newcrest.com.au/investors/market-releases/independent-review-of-disclosure-practices-completed

The author of the independent review, former ASX Chairman Maurice Newman AM FAICD, observed in his report:

> **The ever changing real-time environment illustrates the delicate role played by company management and investor relations departments. In trying to keep markets abreast of developments in rapidly changing circumstances, particularly in the mining area where commodity prices and currencies can be volatile, there will be fine judgement calls as to when to give guidance to analysts and when to make ASX announcements. If announcements are made too frequently they may add to market uncertainty, or, debase their purpose and may themselves be misleading if they are made immediately obsolete by events or other factors. Decisions must be made in real-time while regulatory judgements are made with the benefit of hindsight.**

Following the publication of the independent report, there were a series of changes at board and executive level at Newcrest. Then in June 2014, Newcrest announced it had reached a settlement with ASIC over these events. Under the settlement, Newcrest agreed to two civil contraventions of the continuous disclosure laws and aggregate civil fines of a record $1.2 million. It stated:

> **The contraventions arose from a loss of confidentiality in relation to Newcrest management's expectations concerning Financial Year 2014 (FY 14) gold production and capital expenditure following disclosure of that information to investors and analysts between 28 May and 5 June 2013, and a failure by Newcrest immediately to make disclosure of that information to ASX following that loss of confidentiality.**
>
> **It is not alleged by ASIC that Newcrest knowingly or intentionally contravened its continuous disclosure obligations. The settlement with ASIC does not involve any action being taken by ASIC against individual officers or employees of Newcrest.**[46]

In addition, Newcrest is also subject to class action litigation over the events.

The fine, real-time judgement required of the board to meet its continuous disclosure obligations also came under scrutiny at David Jones. In January 2012 the company was criticised for disclosing an unsolicited bid, which collapsed several days after it was made. Then in January 2014, newspaper reports of a spurned offer for a merger with rival Myer which had been made back in October 2013 raised questions as to whether David Jones had failed to inform the market of the approach at the time it was made.[47]

In a less high profile case, junior miner Reward Minerals Limited, paid a $33,000 penalty in June 2014, following an ASIC infringement notice asserting it had failed to disclose encouraging analysis results. It is worth noting that payment under an infringement notice does not involve an admission or a finding of guilt.

[46] http://www.newcrest.com.au/investors/market-releases/newcrest-reaches-settlement-with-asic

[47] http://www.smh.com.au/business/retail/myer-sought-merger-of-equals-with-rival-david-jones-20140130-31pj0.html

Director share trading

In addition to the continuous disclosure queries faced by listed companies during the year, the issues of director shareholder trading and listed company share trading policies were also subject to public comment. David Jones and its board came under criticism when the then chairman approved the purchase of shares in the company by two directors around the same time as the Myer merger offer (see above). Although ASIC decided not to take action in relation to the share trading, based on the challenge of having sufficient evidence to ground a successful prosecution, in evidence to a Senate committee in March 2014, ASIC's Chairman said if more evidence came to light, the matter could be reopened. Directors were also counselled to consider the perception, or 'front page' test when making decisions about market sensitive matters.[48]

Significant change resulted at David Jones following this controversy, with changes at board level, including of the Chairman. And all this happened in the context of considerable and detailed public scrutiny and press commentary, and pressure for change from major shareholders.

Insider trading and market manipulation

A recent US study of transactions in the period 1996 to 2012 concluded that as many as 25 per cent of all public company deals may involve some kind of insider trading- the disclosure and use of confidential information not generally available in the market.[49] Given the centrality in confidence to the effective operation of public marketplaces, dealing with breaches of insider trading rules has been a regulatory focus for ASIC as the corporate regulator.[50]

Several recent instances of insider trading and market manipulation prosecutions are worth reviewing.

- Kristofer Watts pleaded guilty in May 2014 of market manipulation resulting from trading in Contracts for Difference (CFDs). He was sentenced to two years jail with 21 months suspended.
- Insider trading charges against NAB and Australian Bureau of Statistics employees have been commenced, with ASIC asserting profits of up to $7 million were obtained by foreign currency trading using sensitive statistical information prior to its general release to the market.
- William Hull was charged in May 2014 with 67 counts of alleged illegal insider trading. It is asserted he obtained inside information from a close friend who worked in a global financial services company.

[48] http://www.aph.gov.au/~/media/Committees/Senate/committee/corporations_ctte/asic/hearings_2014/ASIC_ openingstatement.pdf

[49] http://fortune.com/2014/06/17/insider-trading-study/

[50] For ASIC's attitude to these issues see: Price, J., 2014, *'Halting insider share trading'*, Company Director magazine, March.

- John Gay pleaded guilty to insider trading charges in August 2013 and was fined $50,000 and automatically banned from managing corporations for five years. Mr Gay was the chairman of listed Gunns Limited and placed an order to sell more than 3.4 million shares in the company when in possession of inside information about its financial position, which, when made public, lead to a substantial drop in the share price.
- Stuart Fysh was found guilty of insider trading for buying shares in Queensland Gas when his employer was in negotiations to buy that company. He was sentenced to a minimum 12 months in jail, but his conviction and sentence was overturned on appeal in July 2013, with the court deciding that ASIC had not proved Mr Fysh actually knew about the proposed transaction.

Banning orders and insolvency

ASIC has the statutory power to disqualify a person from acting as a company director or managing a corporation for up to five years if, within a seven-year period, the person was an officer of two or more companies, and those companies were wound up and a liquidator provides a report to ASIC that the company is unable to repay its debts.[51]

A high profile example of such an order in April this year was celebrity chef Justin North, banned for two years and his wife for 18 months, following the collapse of his Becasse restaurant. Staff were left with unpaid superannuation in three companies of around $990,000 and other creditors were out of pocket around $7 million. ASIC found Mr and Mrs North had not exercised their powers and discharged their director's duties with the requisite degree of care and diligence.

ASIC's powers under section 206F of the *Corporations Act* 2001 (Cth) are aimed at preventing 'phoenix' operations, where directors set up a new business after the failure of an initial venture, leaving a string of unpaid creditors. Company Directors continues to re-iterate to regulators and others that a company may be placed into external administration for a range of reasons, including external economic or market-related pressures.

In 2013, there were moves to tighten up provisions against directors for being involved with insolvent companies, with the *Insolvency Law Reform Bill* of 2013 proposing automatic disqualification of directors who fail to cooperate with liquidators or administrators. Company Directors had significant concerns about the automatic disqualification provisions proposed in that Bill.[52] Those proposals appear to have lapsed with the change of government last year. Failure to provide information or records remains an offence liable to prosecution, but not for automatic disqualification.

[51] Section 206F *Corporations Act* 2001 (Cth)

[52] See Company Directors' submission to the Federal Treasury dated 8 March 2013 available at www.companydirectors.com.au

Banking and finance developments

Directors will be careful to ensure only designated officers have authority to bind the company to obligations and most have detailed delegations manuals setting out what levels of approvals must be obtained before agreements are entered into. A case recently where despite all that, a director's signature was forged on a loan agreement, brings to directors' attention the statutory rule that those dealing with a company can presume all is in order. In this case, the forger had been allowed over some years to negotiate with the bank for the company and that was sufficient to allow the bank to rely on the presumption, regardless of whether the forger had authority to enter into the particular agreement.[53]

Directors are always concerned when company performance falls below expectation. In the case of *Minumbra Lancewood Pty Ltd v AM Lancewood Investment Nominees Pty Limited*[54] the court decided a company's major decline of profitability against budget could entitle a lender to declare a material adverse change had occurred, thus triggering immediate repayment of the whole debt.[55]

Directors' duties

Since the last Update there have been a number of cases which have alleged breaches of directors' duties. These have included:

- Breach of duties by directors of the Prime Retirement and Aged Care Property Trust, with ASIC stating:

  This is a significant outcome for investors. Directors are important gatekeepers who must discharge their duties with the appropriate care and diligence. This has not happened here. The conduct of the APCHL Board was unacceptable and today's judgment reflects that.[56]

  This case also dealt with the importance of minutes and the care needed when draft minutes are prepared before a meeting.[57]

- Opes Prime Stockbroking Limited director found not guilty of dishonestly breaching his duties as a director (two other directors were jailed in 2011).[58]

- Civil penalty proceedings for breach of directors' duties against the executive directors of Storm Financial are proceeding with appeals currently in train in relation to procedural issues.

---

[53] *ANZ Banking Group Ltd v Frenmast Pty Ltd* (2013) 282 FLR 351

[54] [2013] NSWSC 1929

[55] http://www.allens.com.au/pubs/baf/fobaf15may14.htm

[56] ASIC Media Release 13-339 MR *Prime Trust directors found to have breached duties*, 12 December 2013

[57] *Australian Securities and Investments Commission v Australian Property Custodian Holdings Limited (Receivers and Managers appointed) (in liquidation) (Controllers appointed) (No 3)* [2013] FCA 1342

[58] http://www.smh.com.au/business/banking-and-finance/asic-redfaced-over-opes-prime-verdict-20130906-2ta8f.html

- Directors of Queensland company Selection One Finance were sentenced to four years and three months imprisonment with a non-parole period of 16 months after pleading guilty to failing to exercise their powers and discharge their duties as company directors in good faith in the best interests of the company and that their failure was intentionally dishonest.
- A director of Perth's Aluminex Resources Limited was sentenced to 14 months jail for providing false and misleading information to the ASX.

Director liability

On 16 October 2013, the Queensland Government passed the *Directors' Liability Reform Amendment Act* 2013. The Act amended over 80 pieces of Queensland legislation covering a wide range of subject matter.

The Act was the Queensland Government's response to addressing the director liability reform stream of the Council of Australian Government (COAG) *National Partnership* to Deliver a Seamless National Economy. The COAG reform process was designed to reduce the number of legislative provisions making directors 'automatically' liable for the criminal conduct of the company.

None of the legislation subject to reform under the Queensland Act now contains 'Type 3' liability provisions for directors. Type 3 provisions presume a director is guilty of the corporation's criminal offence unless the director can prove otherwise, reversing the legal burden of proof.

The Queensland reforms represented a critical step forward in reducing and streamlining the liability burden in Queensland and to restoring the fundamental presumption of 'innocent until proven guilty' for directors in that state. Company Directors' advocated strongly on this issue and worked productively with the Queensland Government to achieve this outcome. The changes in Queensland followed similar substantial reforms in NSW and Victoria.

Bribery

The impact of bribery allegations on the reputation of Australian companies has come into greater focus this year.

As has been noted by ASIC Chairman, Greg Medcraft, bribery of foreign officials is a breach of the *Criminal Code* 1995, and criminal action will be taken via the Australian Federal Police. He did, however, warn directors:

> **Don't let it get to that. Have the systems, procedures and protocols to create a culture where bribery cannot exist.**[59]

[59] Medcraft, G., 2013, '*Foreign Bribery and Australian Directors*', Company Director magazine November.

Although the penalties for bribing a foreign official are substantial (corporate fines up to $17 million, three times the benefit of the bribery, or 10 per cent of the annual turnover in the prior year and for directors fines up to $1.7 million and imprisonment up to 10 years), the impacts can be much more pervasive and could include:

- Breach of director's duty.
- Potential for continuous disclosure obligations.
- Potential contractual disclosure (for example under an agency agreement).
- Reputational impact.
- Tax liability.
- Impact on employees and the organisation's employment brand.[60]

Over the last year we have seen serious allegations raised against construction giant Leighton which relate to a $43 million kickback relating to a contract in Iraq, an Indonesian barge contract and a dam building project in Malaysia. Consequences for Leightons have been significant, with a hit to the share price, commencement of class action litigation from shareholders and the resignations of key former Leighton employees from their new roles — including David Stewart, who resigned as chief executive of Laing O'Rourke, David Savage, who quit the board of British engineering group Keller Group plc, and Russell Waugh, who left a senior position at UGL Ltd. Class action litigation is likely to focus on the knowledge of senior executives and board members of the alleged corrupt conduct and the corporate culture in which these events occurred.

Another high-profile case which has continued to receive attention over the last year relates to the Reserve Bank of Australia and its position in relation to Securency and Note Printing Australia (NPA) — both of which are alleged to have been involved in bribery of foreign officials and agents in Malaysia, Indonesia and Vietnam to secure lucrative contracts and visits to Iraq in 1998, despite official sanctions.

The Reserve Bank's interest in Securency was sold in early 2013, however NPA remains a wholly owned subsidiary of the Bank. The Bank's board commissioned an independent report, released in early 2013, into its oversight of these two entities, which concluded:

> **The Bank gave reasonable consideration as to the governance arrangements for the two companies, and put in place processes for their oversight and reporting which were broadly consistent with usual practice at the time. The Bank appointed people whom it was entitled to believe could direct the affairs of the companies with due care, diligence and skill. The Bank received regular reports both at management and board level, and responded to those reports in a considered and deliberate way.**

[60] Cox, C., and Pugsley, C., 2013, '*Avoiding the costs of Foreign Bribery*', Company Director magazine, November.

There is evidence of the Bank taking appropriate action where the entities appeared not to be performing in line with the Bank's expectations and/or standards.

Clearly, with the benefit of hindsight, there could have been more oversight applied to the activities of the companies, which may have detected earlier the alleged illegal payments. But that does not mean that the Bank's oversight at the time was inappropriate.[61]

Criminal charges against various people involved with these companies continue, and media interest has not abated.[62]

While these two high profile cases have involved bribery allegations involving the foreign operations of Australian companies, the local landscape too has focused on improper payments made in Australia for political or commercial favour. In particular, The New South Wales' anticorruption body, the Independent Commission Against Corruption (ICAC), made findings which have had an impact not only on public officials, but also commercial organisations and their directors following their investigation into allegations involving Australian Water Holdings.

Class actions and litigation funders

In a 2013 Victorian Supreme Court of Appeal decision, directors of the failed Timbercorp Finance were absolved of claims they had misled investors following the publication of an allegedly misleading product disclosure statement which failed to disclose key risks.[63] The High Court recently refused special leave to appeal the Court of Appeal's decision.

Herbert Smith Freehills partner Ken Adams, who represented the subsidiary, Timbercorp Finance, said most class actions settled, and this was the first case involving a public company concerning its disclosure obligations that went to judgment in which the directors were vindicated.

Mr Adams said directors could draw some comfort that if things went pear- shaped, and they could show they acted diligently and obtained good outside advice when necessary, they may have a complete answer to criticism.

'On a case-by-case basis, directors shouldn't lose heart simply because of the existence of class actions,' Mr Adams said.[64]

[61] http://www.rba.gov.au/media-releases/2013/mr-13-02-inde-review.html

[62] http://www.afr.com/f/free/national/questions_remain_on_rba_involvement_3c6rUWm9E8byi26IxbOOxI

[63] *Woodcroft-Brown v Timbercorp Securities Ltd* [2013] VSCA 284

[64] http://www.afr.com/p/national/legal_affairs/landmark_timbercorp_ruling_heartens_TT3XYflp0waccgRTV pdP0M

The increased use of shareholder class actions and the rise of litigation funding to cover the often high expenses of those cases has been an issue of concern for directors over recent years.[65]

A draft report from the Productivity Commission, *Access to Justice Arrangements*, recently suggested litigation funders should be required to hold an Australian Financial Services Licence or a separate licence category under the *Corporations Act*.[66] It is expected a final report will be issued later in the calendar year.

In a speech to Company Directors members in June 2014, the ASIC Chairman, Greg Medcraft stated in his view, regulation of litigation funders was a matter for government, but the rise of shareholder class actions was a good thing and had lead to a democratising of the access to justice. He also indicated in assessing whether to take enforcement action itself, ASIC, among other things, would assess the likelihood of private action, including class actions, covering similar issues.

Significant class actions commenced or threatened in recent times have included:[67]

- Treasury Wine Estates Limited.
- Leighton Holdings Limited.
- WorleyParsons Limited.
- QBE Insurance Group Limited.
- Forge Group Limited.
- OZ Minerals Limited.
- Macmahon Holdings Ltd.
- Iluka Resources Limited.

Many of these cases involve assertions that markets were not fully informed about the company's affairs ahead of profit downgrades or other negative announcements. A different kind of class action was resolved in June 2014, with a $38 million settlement of cartel action against companies alleged to have fixed the price of international airfreight services, specifically relating to fuel and security surcharges imposed by the airlines.[68] And in July 2014, an almost $500 million settlement was reached of a class action relating to the Black Saturday bushfires.

[65] See Company Directors most recent submissions to the Productivity Commission dated 14 November 2013 and 19 May 2014 available at www.companydirectors.com.au

[66] http://www.pc.gov.au/__data/assets/pdf_file/0008/135296/access-justice-draft.pdf

[67] See http://www.mondaq.com/australia/x/313730/Class+Actions/Securities+Class+Actions+Escalate+in+Australia

[68] http://www.mauriceblackburn.com.au/about/media-centre/media-statements/2014/australia-s-fourth-cartel-class-action-settles-today-for-38-million/

Directors' and officers' insurance

The Bridecorp case mentioned in last year's Update has been finally decided in New Zealand, with the New Zealand Supreme Court (the highest court in New Zealand), finding that directors of a collapsed company did not have priority access to their Directors and Officers (D&O) policy over the creditors who were suing them.[69] As a result of this decision, directors in New Zealand may have to meet their own defence costs as investors have prior claim on the insurance.[70] In NSW, in contrast, the Court of Appeal held that D&O insurance was not subject to a charge in favour of investors who asserted they had lost money in a failed investment scheme, but was available to pay directors' legal expenses in defending claims against them.[71] Before the NSW decision was handed down, there was concern that there was potential for the New Zealand decision to be followed in a number of Australian jurisdictions (namely, NSW, ACT and NT) where there is equivalent legislation to that considered in the New Zealand case. These concerns have now been somewhat allayed by this decision.

In addition to these decisions relating to 'charges' being placed over policies, D&O policies purporting to cover directors for fines received in respect of criminal conduct have come under attack. Recently, a magistrate in South Australia, considering a D&O policy in the context of a workplace health and safety breach, expressed concern at the existence of such policies. The magistrate imposed a high fine ($200,000 for the director) without the discount that might have otherwise applied due to an early guilty plea on the basis that the D&O policy covered the conduct in question.[72] Although there are policies in the market which cover directors for insurable fines and penalties, following this decision there are concerns that courts and regulators in similar cases might seek to impose non-pecuniary sentences (such as adverse publicity orders or community service orders) where the existence of cover under a D&O policy is found to have impacted on a failure of directors to ensure an appropriate safety or compliance culture. The NSW Chief Justice has also expressed concern about such policies, but has noted that the area is one of uncertainty.[73] Directors should certainly closely examine what is and what is not covered under their D&O policy, but remember that the best defence is complying with their legal obligations.

[69] *BFSL 2007 Ltd v Steigrad* [2013] NZSC 156

[70] http://www.minterellison.co.nz/New_risks_for_directors__Supreme_Court_denies_insurance_cover_for_ defence_costs_12-23-2013/

[71] *Chubb Insurance Company of Australia Ltd v, Margaret Moore and others* [2013] NSWCA 212

[72] *Hillman v Ferro Con (SA) Pty Ltd (in liquidation) and Anor* [2013] SAIRC 22

[73] http://www.supremecourt.lawlink.nsw.gov.au/agdbasev7wr/_assets/supremecourt/m670001l771004/bathurst_ 2013.09.19.pdf

100 Member Rule

In early April the Federal Government released for consultation *the Corporations Legislation Amendment (Deregulatory and Other Measures) Bill* 2014, which contained a number of initiatives aimed at reducing the regulatory burden on Australian business.

The Bill forms part of the government's commitment to reduce red tape, a strategy Company Directors' has advocated will go a long way to increasing productivity, competitiveness and investment in Australia. The proposed Bill includes the repeal of the '100 member' rule which allows 100 members to requisition an extraordinary general meeting of a company.[74]

The '100 member' rule has been a matter of debate since its introduction. The proposed reforms would not the diminish the right of 5 per cent of members to requisition an extraordinary general meeting,[75] place resolutions on the agenda for the company's annual general meeting [76] or request the company to distribute statements to all of its members.[77]

Company Directors supports the proposed repeal of the '100 member' rule and has stated that the repeal would provide a good example of the type of deregulation that would allow business to operate more efficiently, without compromising the fundamental rights of shareholders.[78]

Dividends

As part of the consultation on the *Corporations Legislation Amendment (Deregulatory and Other Measures) Bill* 2014, Treasury proposed an amendment to section 254T of the *Corporations Act* by introducing a solvency test for the declaration or determination of dividends.

This proposed amendment will reduce the regulatory burden on those entities not required to prepare financial statements in accordance with the accounting standards but were previously required to calculate its net assets for the purpose of determining dividends in accordance with those standards.

[74] The rule is currently set out in section 249D(1)(b) of the *Corporations Act*.

[75] Section 249D(1)(a) of the *Corporations Act* 2001 (Cth))

[76] Section 249N(1)(a) of the *Corporations Act* 2001 (Cth))

[77] Section 249P(2)(a) of the *Corporations Act* 2001 (Cth))

[78] See Company Directors' submission to Federal Treasury, *Corporations Legislation Amendment (Deregulatory and Other Measures) Bill* 2014, dated 12 May 2014, available at www.companydirectors.com.au

Constitution

A company's constitution is the contractual foundation of a company's existence, but although directors would commonly be provided with a copy at the time of their appointment or induction, if is often largely forgotten until a problem arises.

In the case of joint venture companies, or companies with smaller groups of shareholders with perhaps disparate interests, it is common also to have a shareholders' agreement. A shareholders' agreement often governs issues such as the majority required for particular decisions to be made, but where the constitution and the shareholders' agreement are in conflict, which document takes precedence?

Although it is common for the shareholders' agreement to expressly state that its terms are to take priority over the rules of the company's constitution to the extent of any inconsistency, directors should be aware there may be circumstances where they both need to be complied with (as well as any provisions of the *Corporations Act* that are not replaceable rules). For example, the recent case in NSW of *Cody v. Live Board Holdings Limited* [2014] NSWSC 78 involved the board of Live Board Holdings Limited resolving to issue preference shares to Bligh Capital (a new shareholder) and ordinary shares to existing shareholders of Live Board Holdings. A dispute arose between an existing shareholder and the board as to whether the share issue was valid and the board consequently sought a declaration from the NSW Supreme Court that it had the power and authority to issue those shares. In the end, the court found the constitution and shareholders agreement were not inconsistent, and both had to be complied with.

Privacy

In recent times, the risk of customers' confidential information being disclosed through the internet has gained particular prominence. Considerable adverse publicity can result in these cases as well as legal sanctions. The challenge presented by increasing use of the internet in commercial and other activities has raised the privacy stakes to a new level.

Australian Privacy Principles

The Federal *Privacy Act* 1988 is the main privacy statute applying in Australia. The Act includes the Australian Privacy Principles which apply to a large part of the private sector and all health service providers and Commonwealth and ACT government agencies. New Australian Privacy Principles replaced the former National Privacy Principles and the Information Privacy Principles from 12 March 2014.

The Australian Privacy Principles (APP) may be summarised as follows:

APP 1: Open and transparent management of personal information

APP 2: Anonymity and pseudonymity

APP 3: Collection of solicited personal information

APP 4: Dealing with unsolicited personal information

APP 5: Notification of the collection of personal information

APP 6: Use or disclosure of personal information

APP 7: Direct marketing

APP 8: Cross-border disclosure of personal information

APP 9: Adoption, use or disclosure of government related identifiers

APP 10: Quality of personal information

APP 11: Security of personal information

APP 12: Access to personal information

APP 13: Correction of personal information[79]

The Privacy Commissioner has made the following comments about APP 1[80]:

The intention of APP 1 is to promote a 'privacy by design' approach — to ensure that privacy compliance is included in the design of information systems and practices from inception. APP entities must implement practices, procedures and systems to ensure compliance with the APPs. APP 1 also requires agencies and organisations covered by the Privacy Act to have a clearly expressed and up to date privacy policy about the way they handle personal information.

An APP Privacy Policy should contain a general description of how the entity manages the personal information it collects and holds…More specifically the policy must contain certain information relating to the:

- **kinds of personal information usually collected and held: eg contact details, employment history, educational qualifications, complaint details, sensitive information, TFNs, health information;**
- **how such information is collected and held: eg directly from individuals or from other APP entities; the agencies usual approach to holding PI: security, whether information is combined with other information;**
- **the purposes for which the entity collects, holds, uses and discloses personal information;**

[79] The full Australian Privacy Principles can be accessed here: www.oaic.gov.au/privacy/privacy-act/australian-privacy-principles

[80] See: speech to iappANZ 'Privacy Unbound' summit, Sydney, 25 November 2013.

- **access and correction procedures;**
- **complaint-handling procedures; and**
- **information about any cross-border disclosure of personal information that might occur, including where practicable, the countries where recipients are likely to be located.**

The Privacy Commission has made the following comments in relation to APP 8[81]:

> **APP 8 is a new principle that addresses the dramatic growth in the global flow of personal information, and the many different ways in which personal information is used, disclosed or stored overseas these days. APP 8 states that in certain circumstances entities will remain accountable for an act or practice engaged in by an overseas recipient of personal information, if that recipient does something that would be a breach of the APPs if the APPs had applied to those acts or practices.**
>
> **Where NPP 9 prohibited cross-border disclosure of personal information, subject to some exceptions, APP 8 aims to permit cross-border disclosure of personal information but also to ensure that any personal information disclosed is still treated in accordance with the Privacy Act. This approach facilitates cross-border disclosure in a manner that ensures appropriate privacy protections are in place and that individuals will be able to seek redress if their information is mishandled.**

Which organisations are covered?

The APPs apply to all businesses (including not-for-profit organisations) with an annual turnover of more than $3 million and all health services providers. A business with an annual turnover of less than $3 million is exempt, unless:

- It is related to another business (for example, a holding company or a subsidiary) that has an annual turnover of more than $3 million.
- It provides a health service and holds health records.
- It discloses personal information for a benefit, service or advantage.
- It provides someone else with a benefit, service or advantage to collect personal information.
- It is a contracted service provider for a Commonwealth contract.

A small business which is not covered may choose to opt-in and be treated as an organisation covered by the *Privacy Act* 1988. One reason for doing this may be to increase customer confidence.

[81] See: speech to iappANZ 'Privacy Unbound' summit, Sydney, 25 November 2013.

The APPS also apply to Federal and ACT government agencies. There are also tax file number guidelines in sec 17 of the *Privacy Act* 1988.[82] Similar but not identical privacy laws or principles exist in all the States and Territories which, for the most part, regulate the way in which personal information should be dealt with by government agencies in those jurisdictions.

Penalties for breaches of APPs

The Australian Privacy Commissioner may apply for court orders for civil penalties for repeated or serious breaches of the APPs — up to $1.7 million for corporations.

A new sec 13G provides for a substantial penalty where an entity does an act, or engages in a practice, which is either a serious interference with the privacy of an individual or repeatedly does an act, or engages in a practice, that is an interference with the privacy of an individual.

Remuneration

Since the introduction of the two strikes rule in 2011, boards have been increasingly sensitive to shareholder and public perception about executive pay.

The Australian Shareholder Association's (ASA) 2014 policy position on these issues focuses on the importance of clear communication and long-term alignment of remuneration with shareholder interest.[83] Company Directors takes the view that a principles based approach to remuneration issues is preferable to mandated corporate governance practices as the latter fails to recognise the range in size and diversity of ASX listed companies.

Company Directors has also long been concerned that proxy advisors have become too influential in providing recommendations to their clients on remuneration issues and they may also apply overly-prescriptive and inflexible policies in making recommendations that do not take into account the company's specific circumstances. However, in a 2013 report, remuneration consultants GRG noted their discussions with proxy advisors indicated a nuanced attitude rather than a formula was being generally applied. Their report advised:

> **What they seem to be asking for is a transparent explanation of KMP remuneration policies and logic, particularly for incentive elements of remuneration and their linkages to company performance…[84]**

And it is clear that voting against the remuneration report is sometimes a tool used by proxy advisors and key investors to express displeasure at corporate performance.

---

[82] See: www.privacy.gov.au

[83] https://www.australianshareholders.com.au/sites/default/files/user-content/resources/file/asa_policies_2014 _0.pdf

[84] http://www.godfreyremuneration.com/documents/130709_RI51_Proxies_and_Stakeholder_Expectations.pdf

Recent examples of votes against remuneration reports include:

- First strike against report from Boart Longyear amid concerns about the company's viability. (May 2014)
- Significant vote against rights granted to Reject Shop CEO with hurdles assessed to be too low by shareholders. (October 2013) CEO resigned in March 2014.
- First strike against remuneration report for David Jones amid board turmoil. (November 2013)
- CEO departs after first strike on remuneration report and Avita Medical launches a review of its remuneration policies. (November 2013)
- First strike against remuneration report for iSelect. (November 2013)
- Second strike against remuneration report at Linc Energy with concerns expressed about company performance.

Remuneration consultants Egan Associates noted although the number of major companies receiving a strike declined in 2013:

> **The lower ASX ranking companies are still finding it difficult to avoid controversy, some because their remuneration policies have not kept up with a swift growth path, others because of large agenda-fuelled shareholding blocks, while a few maintain questionable pay practices.**[85]

Remuneration reporting

In June 2014, ASIC issued a Class Order (CO14/632), which limits certain disclosures required in a company's remuneration report under the *Corporations Act* and the Corporations Regulations. The Class Order is intended to amend an error that has been identified in the Corporations Regulations with respect to the disclosure of shares and options held by a company's directors and senior executives. Currently, the Corporations Regulations require the disclosure of all equity instruments held by a company's key management personnel, regardless of the company that issued the equity.[86] Under the Class Order, companies can now limit this disclosure to those equity instruments held by their key management personnel that were issued either by the company or by any of its subsidiaries.

To rely on the class order, the company must also:

(a) separately specify each class of equity instrument; and

(b) identify each class of equity instrument by:

  (i) the name of the issuing entity;

  (ii) the class of equity instrument; and

  (iii) if the instrument is an option or right — the class and number of equity instruments for which it may be exercised.

[85] http://www.eganassociates.com.au/2013-agm-season-in-review/#secondstrikes

[86] Items 18 and 19 of the table in subregulation 2M.3.03 (1) of the *Corporations Regulations* 2001

The Class Order applies to financial years ending on or before 30 September 2014. It is intended that the Regulations will be amended to address the issue by this time.

Payment of retirement allowances

One of the major criticisms by shareholders of some remuneration arrangements for senior executives and directors during the global financial crisis was the payment of large retirement benefits when company performance was unsatisfactory. Retirement benefits must be approved by shareholders or members in any case:

- where the person held a senior managerial or executive office at the time of retirement; or
- had held such a position any time in the prior three years.

There is an exception where the payment relates to past services and falls under a monetary threshold related to the person's base salary. So often a payment in lieu of notice where there was a contractual provision for a lump sum on early termination will be permitted.

In the recent case of Cummings Engineering[87], a managing director voted himself such a payment. The court decided he was not entitled to keep the payment as he:

- had breached his directors' duties by voting in favour of the ex gratia payment; and
- had forfeited his contractual entitlement to a payment in lieu of notice by failing to give himself notice of termination in circumstances where he knew that the business was going to close but had continued to draw his salary without looking for another job.[88]

[87] *In the matter of Cummings Engineering Holdings Pty Ltd* [2014] NSWSC 250

[88] http://www.claytonutz.com/publications/edition/17_april_2014/20140417/payment_in_lieu_of_notice_may_be_ for_past_services.page

SECTOR SPECIFIC

Family and small business

Although the challenges detailed in the above sections often apply equally to these sectors, they confront a range of additional issues which need careful consideration and decision making by the directors.

Succession planning is a key issue for both small operations and family businesses, with the challenge of family dynamics adding an additional level of complexity to the latter.[89]

Growth and the access to capital is another area for director focus. In its last report before its recent abolition, the Federal Corporations and Markets Advisory Committee reported on the potential of crowd sourced equity funding to foster innovation and promote productivity and economic growth. In its report:[90]

It is proposed that an eligible issuer may seek funds from the crowd by offering its equity through a licensed online intermediary, provided:

- **the offer does not exceed the issuer cap of $2 million in any 12 month period**
- **the offer disclosure requirements are complied with**
- **the controls on advertising are complied with**
- **the issuer does not lend to crowd investors to acquire its shares**
- **any material adverse change concerning the issuer is notified.**

Many small and family businesses are set up as sole director companies. A recent Victorian case involved the transfer of assets from a one director family company to a self-managed superannuation fund whose beneficiaries were also family members. The family company was placed into liquidation, following alleged breaches of duty by the sole director. The beneficiaries of the SMSF sought to recover funds paid in breach of duty. Although the judge decided in the particular case that funds could not be recovered, the case highlights the challenge presented by the multiple roles individuals might play in these common scenarios and the importance of those who leave the management of their financial affairs to other, even to other family members, keeping a close watch on what is happening.[91]

[89] See http://www.business.gov.au/business-topics/templates-and-downloads/Succession-plan-template-and-guide/Pages/default.aspx for tools which may be useful in dealing with these issues

[90] http://www.camac.gov.au/camac/camac.nsf/byHeadline/Whats+NewWhats+New+Home?openDocument. ASIC's attitude to equity funding by this method is here: http://www.asic.gov.au/asic/asic.nsf/byheadline/12-196MR+ASIC+guidance+on+crowd+funding?openDocument

[91] Baxt, R., 2014, *Be wary of the lone wolf director*, Company Director magazine, May.

Another recent case involving the breakdown of relations within a series of family companies led to the winding up of the companies after an expensive and complex court case, including allegations of improper payments made by directors, failure to follow normal corporate processes and exclusion from the management of the company.[92]

The importance of the small business sector to our economy is well recognised by governments and there are a range of online tools available to directors to assist them in helping their businesses flourish.[93]

Not-for-profit (NFP)

The increasing demands on NFP boards and the challenges they encounter in dealing with change have been issues of interest since the last Update.

Many of the larger charities have been grappling with increased competition for donor funds and the need to demonstrate efficiency in their operations. Some have made progress from state based membership based structures with their own budgets and fundraising, to national structures with centralised and coordinated activities. The strategic balance between efficiency and maintaining state engagement can be a challenge for boards in this arena, often complicated by the dual role often played by board members in representing their state or territory as well as operating at a national level.[94]

The 2013 *Directors Social Impact Study* released by Company Directors also found maintaining or building income was the top priority for NFP boards.[95] Directors highlighted the increasing competition for revenue while operating in sectors in which cost are growing at a faster pace than income.

In the regulatory space, not-for-profit entitles are still currently obliged, when covered, to comply with reporting requirements of the Australian Charities and Not-for-profits Commission (ACNC). At this stage it remains unclear whether or when the Government's stated objective of abolishing the ACNC will be achieved.

Company Directors has made on a number of submissions regarding NFP regulation and consistently repeated its view that the charity sector (and the broader NFP Sector) would benefit from:

- reduction of red-tape;
- harmonisation of Federal, State and Territory Regulations; and
- a 'one-stop-shop' for reporting to government(s).

---

[92] *In the matter of Ledir Enterprises Pty Limited* [2013] NSWSC 1332

[93] For instance, http://www.treasury.gov.au/Policy-Topics/Business/Small-Business

[94] An example is the Red Cross, see *Modernising the Red Cross*, Greg Vickery talking to Christopher Niesche in Company Director magazine, November 2013.

[95] http://www.companydirectors.com.au/~/media/Resources/Director%20Resource%20Centre/NFP/Directors%20Social%20Impact%20Study%202013.ashx

In any event, the focus on governance standards in this sector is likely to proceed — driven by donors, funders and the sector itself. Governance failures within NFPs are of great public interest and can result in negative personal impact on the reputation of individuals involved. Recent events relating to the NSW Parents and Citizens Federation, which involved various groups making claims they were in charge of the Federation, went as far as court proceedings[96] and finally the dissolution of the body by the State Education Minister, to be replaced with a new body created by legislation.[97]

State owned corporations

The NSW Government is currently reviewing the legislative framework that provides for the governance and accountability of State owned corporations in NSW.[98]

The Review will examine the *State Owned Corporations Act* 1989 (NSW) and eight enabling Acts that establish State owned corporations. The Review plans to make recommendations to the Government for legislative change to improve the commercial performance of state owned corporations and streamline and strengthen the state owned corporation accountability and governance framework.[99]

The Review Steering Committee is expected to deliver a policy position paper to the NSW Cabinet in mid to late 2014.

At the Federal level a new Act came into force at 1 July 2014 — the *Public Governance, Performance and Accountability Amendment Bill* 2014[100] amends the *Public Governance, Performance and Accountability Act* 2013.[101]

Superannuation

Building on the Federal Government's election commitment to restore stability and certainty to Australia's superannuation system, in late 2013 a discussion paper was released and submissions were called for on the issues of governance, transparency and default superannuation funds in modern awards.

[96] http://www.smh.com.au/nsw/pc-feud-goes-all-the-way-to-supreme-court-20140420-36ywq.html

[97] http://www.dec.nsw.gov.au/about-us/news-at-det/media-releases1/reforms-to-create-a-new-p-c-federation

[98] http://www.dpc.nsw.gov.au/about/publications/improving_the_effectiveness_of_state_owned_corporations

[99] See Company Directors' submission to the Review of State Owned Corporations dated 28 February 2014, available at www.companydirectors.com.au.

[100] http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r5268

[101] http://www.pmra.finance.gov.au/files/2012/11/pmra-newsletter-12-1july.pdf

One of the key issues raised in the discussion paper was how best to ensure an appropriate provision for independent directors on superannuation trustee boards, including how 'independence' could be defined and what could constitute optimal board composition.

Broadly speaking, the measures proposed in the discussion paper will generally lead to marked improvement in the governance practices of superannuation funds. With respect to the need to increase independent directors on superannuation trustee boards, it was noted there should be sufficient independent directors appointed to superannuation trustee boards so they can genuinely influence and affect the decisions of the board and that it is widely accepted that at least a majority of the directors on a board should be independent. It was also noted the chairman of a superannuation fund's board should be independent.

Sporting bodies

The year has seen an increasing focus on the governance responsibility of directors of sporting bodies.

A high profile example relates to the Essendon Football Club, which is currently involved in court proceedings relating to investigations by the sports anti-doping authority, ASADA. Dr Switkowski AO FAICD reported on some elements of the allegations of misuse of supplements and spoke of the governance failures in the organisation. His report made a range of recommendations, many of which might well be considered more widely. For example, he said:

> **Bad news must be passed up the line quickly. Sometimes, organizations seem to have holding depots where issues await a fix while being shielded from upper management and the board. This is poor practice. Boards should ask the question 'what's keeping you up at night?' and follow up and monitor action on concerns. Boards should not resile from detailed interrogation of operations, including within the football department, even when times are good.**[102]

ASADA investigations at Cronulla Sharks also lead to a change at the board level and controversy about the appointment of the Club's coach. The NRL also took action, fining the club $1 million dollars of which $400,000 was suspended subject to the satisfaction of governance changes and compliance with the NRL Rules.

In relation to the Club, the governance measures required to be put in place include:

- The completion of an independent governance review.
- An assessment of the Club's risk and control reporting framework.
- Appointment of additional resources in the Club's football department.
- Compliance with new supplement and medication rules.[103]

[102] http://www.essendonfc.com.au/news/2013-05-06/dr-ziggy-switskowski-report

[103] http://www.nrl.com/decision-on-sharks,-flanagan-and-elkin/tabid/10871/newsid/76586/default.aspx

And following the disappointing performance of the Australian swimming team, the Australian Sports Commission (ASC) commissioned a report into the sport's governance. Recommendations included:

- **SAL Board of Directors and senior management must take a leading role in implementing change within the sport that promotes a culture of success, accountability and transparency throughout the sport of swimming.**
- **To have a balanced Board with the support of the membership, SAL must use its Nominations Committee, operating under a clear charter, to manage succession planning, identify gaps and put forward preferred candidates to the members to endorse.**
- **To promote Board renewal while retaining corporate memory, SAL must introduce maximum terms for directors under a staggered election system.**
- **To create a Board where all are equal, improve decision-making processes, and remove division among the membership, the Board must determine who undertakes the role of Chair.**

The ASC has also published governance guidelines[104] for sporting bodies, taking account of the wide range of structures, size and history of the organisations in this sector. These guidelines cover:

- Board composition, roles and powers.
- Board processes.
- Governance systems.
- Board reporting and performance.
- Stakeholder relationship and reporting.
- Ethical and responsible decision making.

The 2013 *Directors Social Impact Study* released by Company Directors[105] found the governance of sporting organisations may be less effective than the governance of other not-for-profit organisations. It also found sports boards are undertaking less professional development than others.

[104] http://www.ausport.gov.au/__data/assets/pdf_file/0004/563629/ASC_Governance_Principles.pdf

[105] http://www.companydirectors.com.au/~/media/Resources/Director%20Resource%20Centre/NFP/Directors%20Social%20Impact%20Study%202013.ashx

CONCLUSION

The last year has seen some encouraging developments — some stabilisation of the legislative framework facing directors, progress in the area of diversity — particularly with the increased appointments of women to ASX listed boards, and changing market conditions reinvigorating the mergers and acquisitions space.

However, there are still challenges ahead and set targets are still to be reached. Inevitably the task for boards is to maintain a focus on the long-term sustainability of their organisations.

As always, the range of new technologies and ICT governance issues continue to challenge directors. Maintaining oversight and being able to recognise the disruptions from the potential positive strategic impacts is key.

This material is provided as background to The Essential Director Update seminar (also available as a webinar) developed for Australian Institute of Company Directors members. The issues outlined here have received attention in the last 12 months.

The material has been prepared by Rebecca Davies FAICD. Rebecca has served on boards in the corporate, not-for-profit and government spheres, as non-executive director and chairman. She currently sits on the boards of LCM Healthcare, Chris O'Brien Lifehouse, Palestrina Foundation and the Juvenile Diabetes Research Foundation in Australia and its international board. She is also President of the Heart Foundation, NSW Division. She was a partner of Freehills for 26 years, held a range of management roles in the firm and served as an elected member of its board.

Prepared July 2014

Disclaimer

Copyright

Australian Institute of Company Directors

Contact information

General enquiries
t: 1300 739 119
e: contact@companydirectors.com.au

National Office
Level 30, 20 Bond Street
Sydney NSW 2000
t: 02 8248 6600
f: 02 8248 6633
e: contact@companydirectors.com.au

Pacific enquiries (New Zealand, Papua New Guinea, Solomon Islands, Fiji)
Pacific Member Relations Executive
GPO Box 73
Brisbane QLD 4001
t: +61 7 3222 5500
f: +61 7 3222 5522
e: pacific@companydirectors.com.au

International enquiries (other)
Overseas Member Relations Executive
PO Box 7050
Cloisters Square WA 6850
t: +61 8 9320 1701
f: +61 8 9320 1722
e: international@companydirectors.com.au

Australian Capital Territory
GPO Box 1371
Canberra ACT 2601
t: 02 6132 3200
f: 02 6132 3222
e: act@companydirectors.com.au

New South Wales
Level 30, 20 Bond Street
Sydney NSW 2000
t: 02 8248 8400
f: 02 8248 8444
e: nsw@companydirectors.com.au

Queensland
GPO Box 73
Brisbane QLD 4001
t: 07 3222 5500
f: 07 3222 5522
e: qld@companydirectors.com.au

South Australia/Northern Territory
GPO Box 482
Adelaide SA 5000
t: 08 8236 2800
f: 08 8236 2833
e: sa-nt@companydirectors.com.au

Tasmania
PO Box 1090
Sandy Bay TAS 7006
t: 03 6242 2200
f: 03 6242 2222
e: tas@companydirectors.com.au

Victoria
PO Box 380
Collins Street West
Melbourne VIC 8007
t: 03 9245 4200
f: 03 9245 4222
e: vic@companydirectors.com.au

Western Australia
PO Box 7050
Cloisters Square
Perth WA 6850
t: 08 9320 1700
f: 08 9320 1722
e: wa@companydirectors.com.au

04372-6_14

“I would like to say thanks to the dedicated staff at Company Directors and for the opportunity to attend the conference in Hamilton Island. The conference was a great way for me to reacquaint myself with the Institute and was an enjoyable learning experience. The event was a well-structured, balanced program involving well respected speakers providing current, modern thinking. The surprise, I suppose, was how easy it was to meet people and network.”

– Peter Lodge FAICD, 2014 Conference scholarship recipient

Pre-registrations now open

Company Directors Conference Directorship:15

Kuala Lumpur: 20 - 23 May 2015

For pre-registration and enquiries contact Jess Murray
t: 02 8248 2756 e: jmurray@companydirectors.com.au

AUSTRALIAN INSTITUTE *of* COMPANY DIRECTORS