

2015 SURVEY REPORT

# Corporate governance for energy and resources companies

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**Corporate governance  
for energy and resources  
companies**

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**The team from the University of Western Australia  
and KPMG are proud to publish the results of their  
second survey: Corporate governance for energy  
and resources companies. The first survey was  
released in 2013.**

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# At a glance

## 103



responses were received from directors and company secretaries of mining and oil & gas companies with market capitalisation ranging from

**< AUD50m to >AUD1bn**



Most boards have an audit and risk committee and a remuneration committee, with most large companies also having a nomination committee.

## Monthly board meetings



are most common. Half of the boards of small companies and one-third of the boards of medium and large companies communicate on a weekly basis, in addition to normal responsibilities.

Based on the size of a company, the most common director numbers on boards were:

- 4** (<AUD50m)
- 5** (AUD50 – 499m)
- 7** (>AUD500m)

**26** had operations in Africa.

**8** had operations in South America.

## 13%

of respondents had measurable corporate responsibility and sustainability goals in their annual report.



Average number of independent directors were:

**1-2**

for small companies

**3**

for medium companies

**5**

for large companies

**67%**

of all directors think their board size is just right.

**44%**

of boards require full board approval of announcements to the market.

**61%**

of respondents with overseas operations rated bribery and corruption as a matter for concern.

Most respondents saw raising equity capital, commodity price volatility and exchange rate volatility as the **biggest challenges**.

**Most commonly produced reports** were the financial performance report, CEO report and operations report. Most large company boards also obtained a health and safety report, environmental report and risk management report.

# Executive summary

The energy and resources sector is crucial to the sustainable success of the Australian economy. But it also has an important international dimension, with over 40 respondents having operations overseas.

Since our last survey in 2013, the market has become more challenging as reflected by falling prices, reduced demand and ongoing global threats to the broader market.

The main challenges and risks have remained relatively constant over this period, with raising equity capital and volatility in commodity prices and exchange rates being seen as the biggest challenges by respondents in both surveys.

There is no doubt that the effect of these challenges and risks have been felt differently depending on whether a company was in production, and on what it was producing. The pain suffered by iron ore miners and their contractors in recent times has been well publicised. Companies not yet in production, and accordingly without operating cash flow, are very dependent on the stock market to raise equity. Investors have had a limited appetite to invest in explorers and developers in the period between the surveys. Although many of those companies have been able to scale back their staff and other expenditure, the crunch time has arrived for more than a few - with some converting from resources into technology companies (a similar trend to what we saw in the late 90's).

We see the outworking of two cycles; the cycle of those companies able to move through development and into production and then the 'boom and bust' cycle of commodity related markets. Notwithstanding, the optimistic views about the super cycle of as recently as 2010, this cycle has proved to be like many previous cycles tracing back to the 1960s, albeit that this one lasted longer.

We had anticipated that the commodity related cycle would see companies slim down their boards. That has not being the case for respondents. Four directors remains the most common board size for small companies, with one to two of these being independent directors.

Through this survey we have been able to confirm a number of the conclusions of the 2013 Report. For example:

- Irrespective of size most companies have an audit (or audit and risk) committee and remuneration committee, and to a lesser extent, a nomination committee.
- The board charter remains the most common framework document with 95 percent of companies in the survey having one.
- The board size is on average 5 for medium companies and 7 for large, with those having respectively 3 and 5 independent directors. Obviously with this small number of independent directors many small companies are not able to have sufficient independent directors to satisfy the ASX's corporate governance guidelines and are taking advantage of the "if not why not" option.

These conclusions represent the kind of choices that boards have to make as the company develops and obtains operating cash flow. What we have sought to do with this survey, as with the last one, is to give peer information as to the choices being made by other companies.

In some ways the easier choices relate to board size, framework documents and board committees. The harder choices relate to things like the reports and indicators, how they are reported to the market and the degree of independent verification. While there is apparently a significant difference between the ways that large companies operate as opposed to small, there is still an issue for all companies in designing a corporate governance system that is fit for the company in its circumstances.

In assessing current challenges and risks, respondents expressed concern about volatility of commodity prices and exchange rates. This resonates with the responses of over 1500 audit committee members that responded to the KPMG Global Audit Committee Survey<sup>1</sup>. The common factor in both surveys is the perceived risk of increased or changing regulation. You don't have to look hard to see that governance and regulatory changes on the horizon are gaining momentum and not slowing.

In an environment of constant technological advancement, it was surprising that information technology risk presented by cyber, cloud, social media etc, was placed seventh out of thirteen. We would expect this to continue to rise in importance in future years - presenting a challenge to boards and directors on their preparedness to respond - both professionally and from the company's perspective.

As our businesses operate in an increasingly globally connected world, we see the flow-on impacts of our regulators and governance setting bodies talking more with each other. This inevitably means that the developments in the UK, Europe and the USA are likely to impact Australian businesses within a short period of time. The UK Corporate Governance Code requires that directors confirm that the company's annual report and accounts taken as a whole are fair, balanced and understandable. As a result the directors are looking for more ways to gain assurance that the risk management systems and processes are in place to allow them to make such assertions.

In conclusion, it seems the director's concerns regarding expectations around governance and regulatory change are well founded. This document seeks to explore some of the ways that international and local practices are evolving with regard to those surveyed and we trust the readers find this work interesting and relevant.

<sup>1</sup> [www.kpmg.com/AU/en/IssuesAndInsights/ArticlesPublications/global-audit-committee-survey/Pages/global-audit-committee-survey-2015.aspx](http://www.kpmg.com/AU/en/IssuesAndInsights/ArticlesPublications/global-audit-committee-survey/Pages/global-audit-committee-survey-2015.aspx)



# Survey participants

Our survey captured companies in a range of categories relating to size, project lifecycle, commodities, region of operation and listings. We have, through the report, highlighted results relevant to these categories to emphasize the corporate governance practices and issues relating to them.

## Size

# 45

small companies



(those with a market capitalisation of less than AUD50 million)

# 31

mid-sized companies



(those with a market capitalisation of less than AUD50 million to AUD499 million)

# 17

large companies



(those with a market capitalisation of over AUD500 million)

## Project lifecycle

Of those companies surveyed the following breakdown shows their most advanced stage of development. Some were undertaking several activities simultaneously and many were exploring either exclusively or in conjunction with other activities<sup>1</sup>.

# 18

companies undertaking pre-feasibility



# 21

explorers



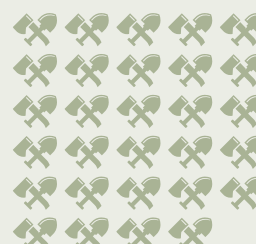
# 20

companies with projects in development



# 29

producers



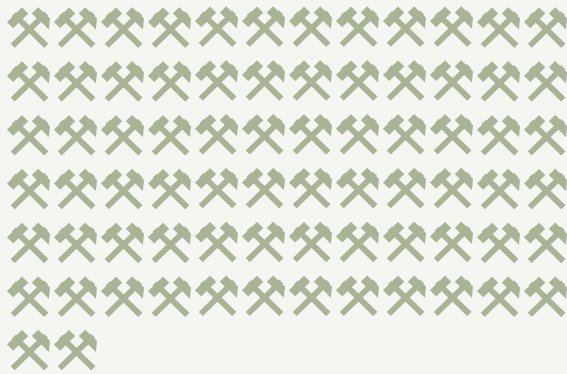
<sup>1</sup> remaining organisations (5) operate in the services sector.



## Sector composition (% of total respondents)

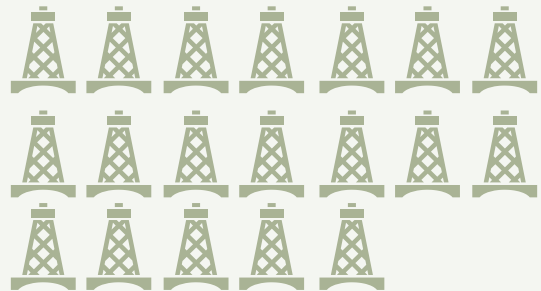
### Mining

**74** 80%



### Oil and Gas

**19** 20%



## Region of operation

A significant number of companies had operations overseas: Africa (26), Europe (8), South America (8), USA (7), Indonesia (6), New Zealand (5), Canada (5) and China (4).



## Stock Exchange listings

Nearly all companies included were listed on the ASX with a number of respondents listed elsewhere - Toronto being the most popular. The other exchanges noted from our survey, not specifically listed, are quite diverse and include Frankfurt and Namibia.

“You really need policies which are comprehensible to the whole work force. This is critical in areas like safety, codes of conduct, and policies dealing with bribery and corruption, but it is true at a general level as well. There can be language and cultural elements to this as well if you have employees in more than one country.”

# Challenges and risks

Boards are responsible for ensuring that a company is nimble enough to respond to changing market conditions, by taking advantage of opportunities and managing risks.

One of the key roles of directors is to develop, often with management, a company's vision and strategic direction, to scrutinise key financial risks and to ensure effective management of risk and compliance.

Survey participants were asked how challenging a range of issues were for their company. The findings show that boards are continuing to experience a wide range of challenges, with some such as volatility in commodity prices, finding cost reductions and access to capital and bank finance, being considered "very challenging" or "extremely challenging."

# Findings

## Challenges

Consistent with the survey in 2013, the following issues were rated highest by respondents:

- Raising equity capital 62 percent compared to 69 percent in 2013
- Volatility in commodity prices 63 percent compared to 54 percent in 2013

In smaller organisations, there was equal weighting applied to the ability to access bank finance and the ability to raise equity capital, whereas the medium and larger organisations appeared less concerned about bank finance. Indeed the majority of large organisations were more concerned about increasing costs and the ability to identify cost reductions. This is fundamentally a consequence of the stage of operational maturity of these organisations and does tell a consistent story of the working capital constraints being experienced across the market.

Interestingly, virtually equal bearing was given to the challenge of rising costs and increasing regulation in the larger organisations. The connection between regulatory compliance and costs cannot be ignored in this context. Regulation at all levels of business and in all areas continues to increase and with it a reporting burden and a need for systems and procedures, as organisations grow in size and complexity. Further, increasing pressure from shareholders and institutional investors in recent years for larger organisations to strictly apply the ASX Corporate Governance Principles, rather than employ the “if not, why not” discharge, may also be contributing to the angst relating to regulatory concerns. We anticipate there is a strong possibility this will continue to increase into next year as we enter a federal election year and uncertainty around possible regulatory change builds.

When separating the respondents by stage of operations, 64 percent of the organisations at production stage commented on the volatility in commodity prices and exchange rates being either very or extremely challenging. Those in pre-feasibility and development stage didn't discount this challenge. However, they emphasised a greater challenge from the ability to access finance and equity. Given that the root cause underlying the latter is principally the markets' concerns regarding the volatility of commodity prices, the responses tend not to reflect a different view by the various stages of operations, but rather where the organisations are experiencing the pain of this volatility at the moment.

KPMG's Global Audit Committee Survey for 2015<sup>1</sup> reported a similar list of challenges arising from respondents with uncertainty and volatility (economic, regulatory and political) and government regulation (impacts of policy changes) being the top two challenges reported by global respondents. This differed only slightly when analysed by Australian respondents who viewed operational risk and challenges regarding an effective control environment above challenge from government regulation. This aligns with **Figure 1**, with the exception of the expected focus from the mid-tier resource sector on financing, capital and cost challenges.

## Risks

When asked about areas of risk that most concerned them in 2014, as in the previous question, participants focused in particular on commodity price and exchange rate volatility and funding difficulties - **Figure 2**.

Those risks rated either 'extremely' or 'very challenging' by most respondents were:

1. Funding Projects, which was included in the survey for the first time, with 64 percent
2. Commodity price and exchange rate volatility 64 percent (compared to 51 percent in 2013)
3. Liquidity at 38 percent (consistent with 2013).

In the previous survey, increasing costs rated as very challenging. Interestingly, increasing costs reduced in its ranking in the current survey with 27 percent of respondents noting this as one of the top risks compared to 41 percent previously. This may indicate that organisations are better managing their supply chains and realising the benefits of funding options which may be available.

<sup>1</sup> [www.kpmg.com/AU/en/IssuesAndInsights/ArticlesPublications/global-audit-committee-survey/Pages/global-audit-committee-survey-2015.aspx](http://www.kpmg.com/AU/en/IssuesAndInsights/ArticlesPublications/global-audit-committee-survey/Pages/global-audit-committee-survey-2015.aspx)

Figure 1: How challenging did your company find a range of issues?

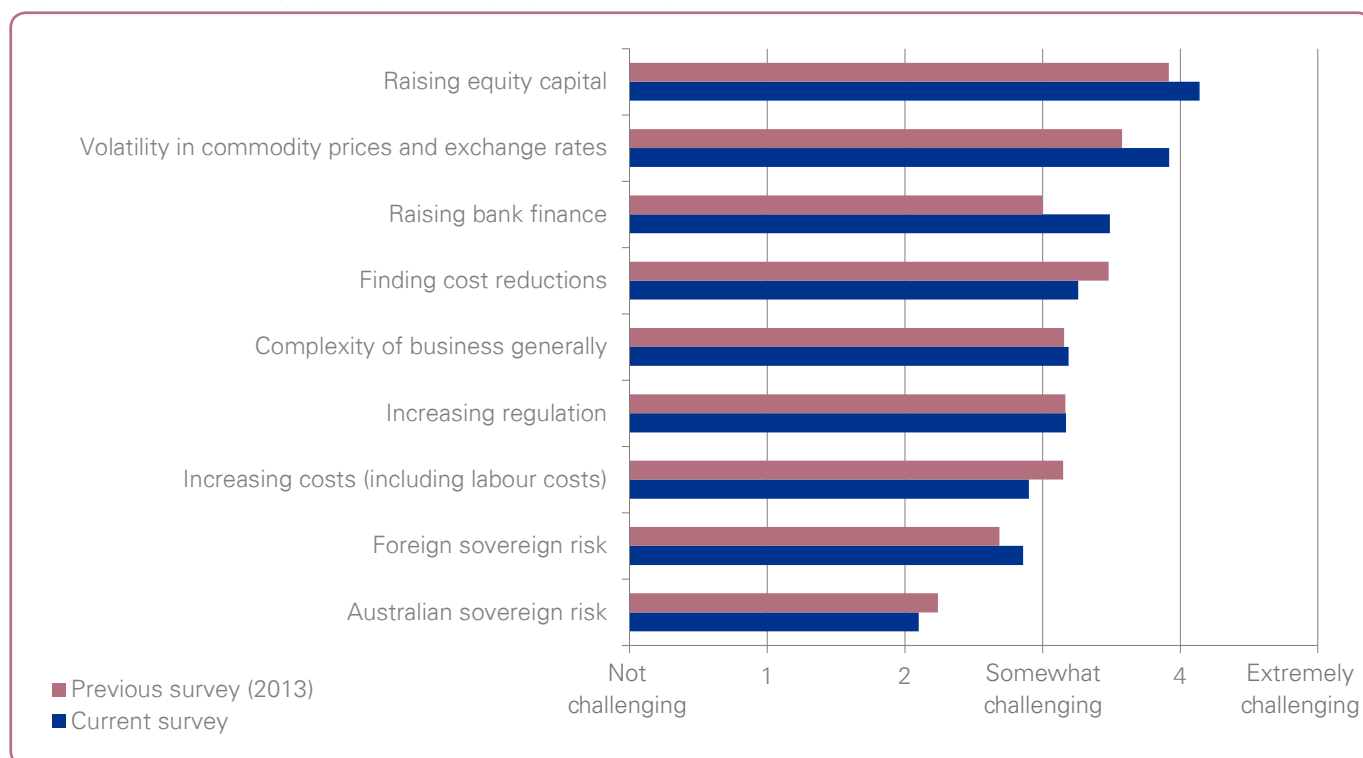
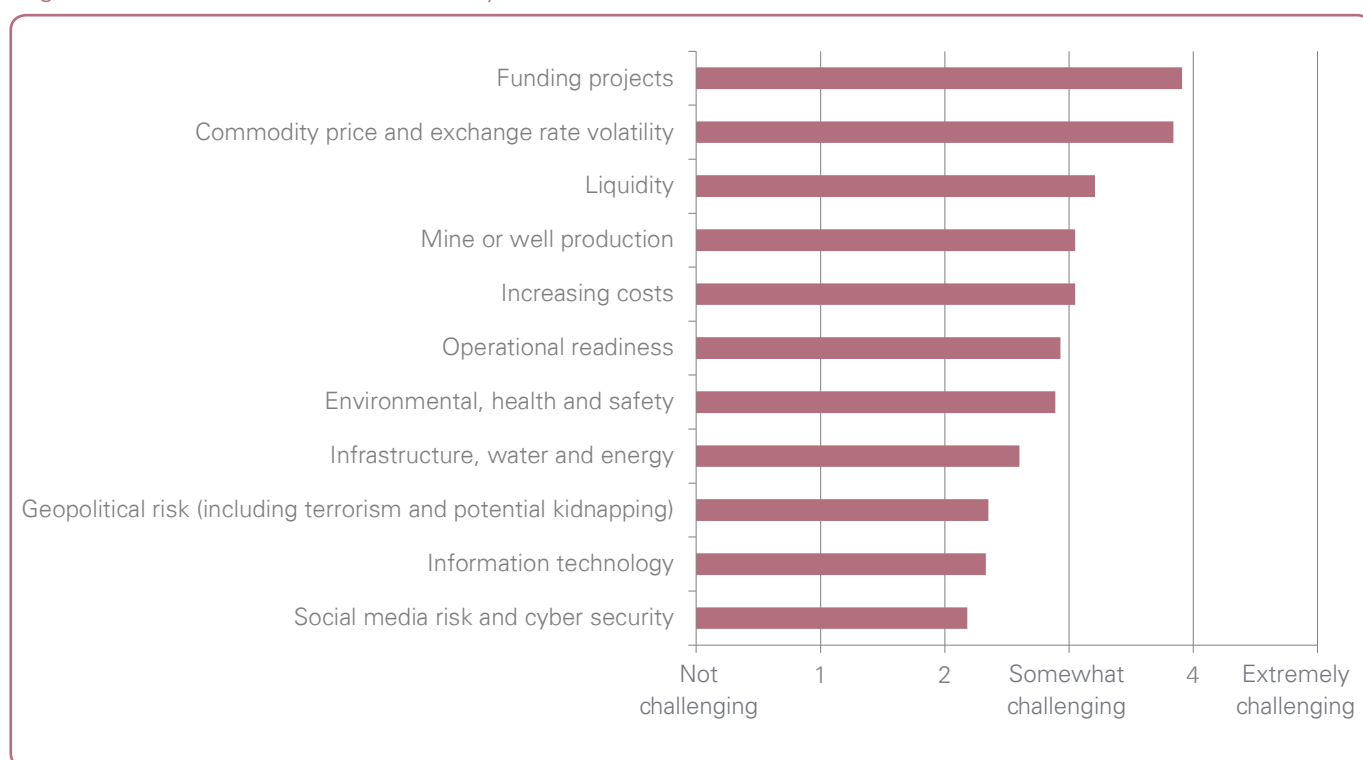


Figure 2: What areas of risk are currently of most concern?





**Table 1** summarises the top three risks by organisation size and an overall ranking based on the number of responses.

Table 1: Top risks by organisational type

Ranking	Overall	Large	Medium	Small
1	Funding projects	Commodity price and exchange rate volatility	Commodity price and exchange rate volatility	Funding projects
2	Commodity price and exchange rate volatility	Environment health and safety	Funding projects	Commodity price and exchange rate volatility
3	Liquidity	Mine or well production	Liquidity	Liquidity

Notwithstanding the order, the results were relatively consistent across respondents, with the exception of those responding for large organisations.

In the current economic climate it is the smaller organisations who are experiencing the greatest pain and the survey outcomes are an indication of this. Larger organisations often have greater flexibility to drive cost reduction, building a level of resilience which the smaller organisations do not have the benefit of. Some of the changes being made by organisations to reduce costs include reducing head counts and altering the approach to supporting processes like maintenance and rehabilitation. This can have a negative impact on health, safety and environment risks, with increased injuries arising from staff working under greater stress in an environment with a reduced focus on preventative maintenance. Similarly, working capital savings from reducing the level of rehabilitation to meet the minimum requirements only increases the risk that the minimum may not be met. Accordingly, the increased focus on environmental, health and safety risks may be partly as an outcome of the same cost pressures that the small and medium sized organisations are reporting. This is also certainly an area that social media has increased the pressure on.

Out of the risks presented in the survey, environment, health and safety is the one risk that now requires an accelerated response due to the increased risk velocity arising from the force of NGOs and the general public using social media as a communication tool or weapon.

Whereas the small and medium organisations reported that funding of projects was in the top three risks, large organisations cited production (mine or well) to be of greater significance at this time. Part of the reason for this may be that the small and medium organisations in the survey are frequently still at the project development stage and, hence, funding projects equates to business continuity. Many of the larger organisations surveyed also have projects in train but typically these larger organisations will have a proven track record of production resulting in project funding being possibly easier to obtain than for smaller organisations. Further, cashflows arising from existing production may be utilised to fund projects in larger more mature organisations. Hence, maintaining production in the evolving low cost environment is a greater risk.

Ultimately, regardless of how the risks are ranked, when taken together the underlying message is that organisations see business continuity as their major risk which is reasonable given the current economic climate.

# Insights

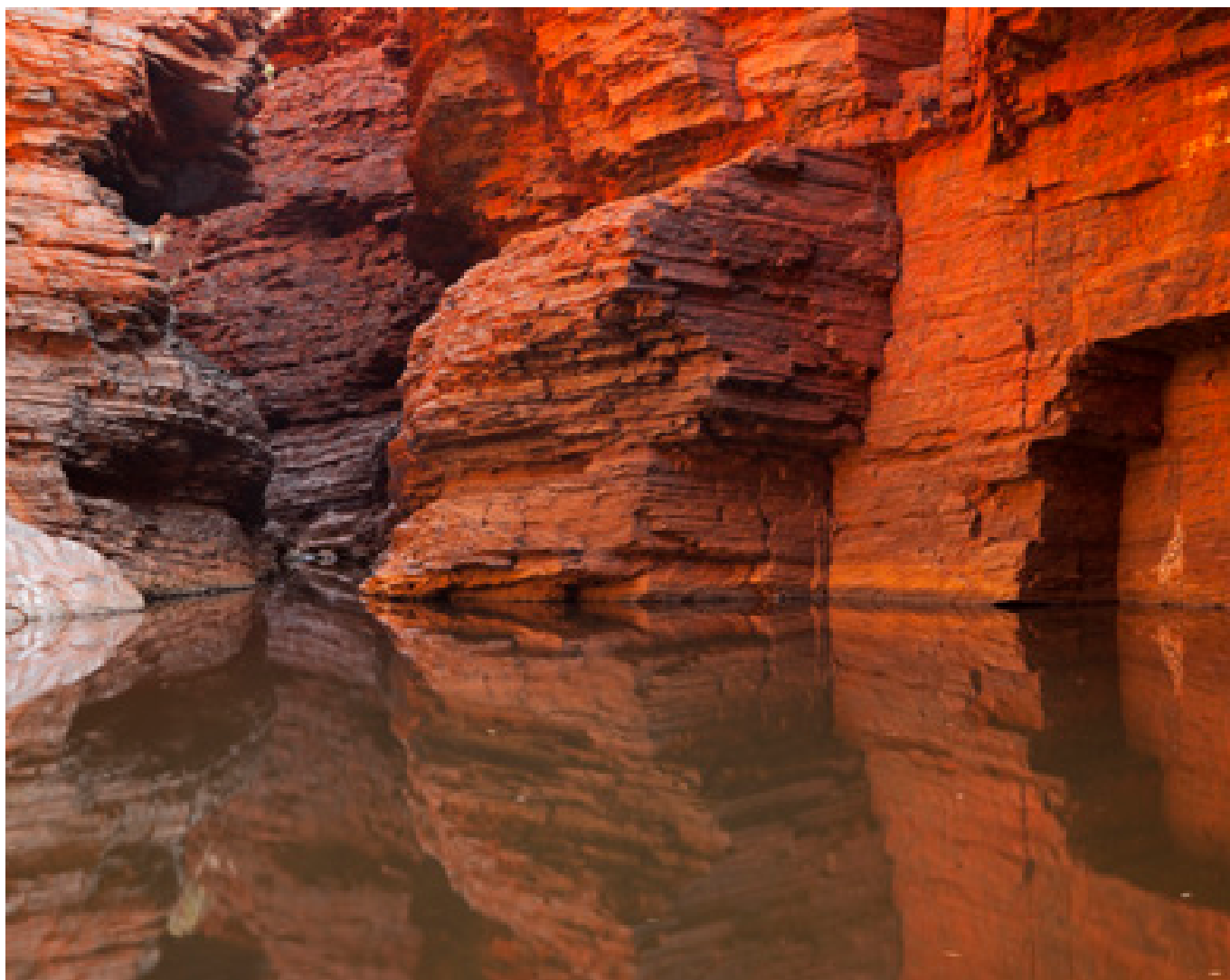
## Current challenges and risks

Many organisations understand that achieving their strategic objectives is inextricably linked to their ability to manage risk and harness opportunity. But many still struggle to identify those risks and opportunities that truly matter to their company's strategic framework.

The severe downturn in most commodity prices in the past 24 months has placed a substantial onus on boards to manage a range of heightened risks and deliver results under difficult market conditions. Two years ago we saw high operating costs, high wage costs and a high Australian dollar. Since then corporates have been moving quickly to cut these costs, in many cases resetting salaries and wages down and the Australian dollar has helped marginally by remaining in a band trading between 75 – 85 cents to the USD.

Boards are not only struggling to access equity capital and debt finance, but are also working hard to keep their operations productive in an environment where the flow-on effect of lower exchange rates, and a drop in labour costs, have not yet fully filtered through.

As our businesses operate in an increasingly globally connected world we see the flow on impacts of our regulators and governance setting bodies talking to each other. This inevitably means that the developments in the UK, Europe and the USA are likely to impact Australian businesses within a short period of time. The UK Corporate Governance Code requires that directors confirm that the company's annual report and accounts taken as a whole are fair, balanced and understandable. As a result the directors are looking for more ways to gain assurance that the risk management systems and processes are in place to allow them to make such assertions.



## Risk culture

It is critical that risk management evolves from compliance monitoring and problem prevention to value enhancement. To extract the most value from the risk function, organisations need to develop a holistic and commercially minded approach to risk management.

Successful organisations have strategic risk functions or processes that identify emerging trends, longer-term opportunities and risks to help drive performance and resilience. They ensure that the accountability for identifying and managing risks is embedded within the business with clear escalation mechanisms. They understand the power of 'conscious risk taking' within the boundaries of the business's risk model.

Key drivers for organisations to improve their ability to withstand shocks (risk resilience) include increasing economic losses from global events, which decrease the affordability of insurance premiums. Coupled with a growing economic imperative to proactively invest in risk resilience to avoid disruption, there is increasing expectation by investors and other stakeholders around disclosure on these matters (eg. planning and preparedness).

As such, organisations need to understand how external stresses and shocks are creating vulnerabilities within their systems and then determine how they can be adapted to improve their resilience.

New risks are expected to emerge and redundant risks retire as technology and cultures change. Accordingly, some of the risks we have previously enquired about in the survey (like solvency) have been replaced by risks that have emerged rather suddenly in the last two years - funding projects, social media and cyber security etc. Whilst social media and cyber security are risks in themselves, the further risk presented by social media is how it can accelerate the impact of other risks and incidents (the risk velocity) and as such it is itself changing the way that other risks are being viewed and managed.

## Tools and planning

To best manage this changing environment, there is a need for organisations to have a 'live' Risk Matrix and Scenario Planning process in place, regardless of their size. Boards need to be confident that they can be alert to any triggers that could see a change in risks. Furthermore, it is critical for boards to understand and manage the strong interconnectivity of risks in their company and understand how they impact on each other.

Risk management processes also need to line up with the risks that directors are seeing as important to the business. For example, if access to capital is a major issue for a company, the board should be aware of what triggers, what timing and what likely impact a failure to access capital in a timely manner will have on the company. Without that discipline, single project companies could become stranded as commodity prices or exchange rates move against them. Directors also need to be aware of, and be prepared for, the likely longer term commodity cycles and their impact on future project outcomes.

## Risk appetite

Boards should consider their appetite for risk, ensuring that the same level of appetite is not only shared and clearly understood by the board and management, but applied throughout the company in daily business operations. There needs to be a clear understanding of the company's willingness to take on risk. The easiest and most common way to achieve this is through interface of the risk appetite and delegations of authority.

# Considerations for Directors

During volatile times, and with numerous and changing risks, boards need to fully understand their role in identifying and managing strategic risk challenges.

Matters to consider include:

- Is risk management (culture, process and structures) in your company connected to corporate strategy, and is it driven from the board and not seen as a compliance exercise?
- Is the identification and management of risk built into strategic planning decisions through a risk matrix approach?
- Do you understand the timelines for accessing capital markets and plan ahead - especially if you need to access capital over the next 6 to 18 months in the current volatile environment?
- Do you undertake regular scenario planning and stress test growth plans for seemingly improbable outcomes to ensure that the board is aware of possible short and longer-term risks?
- Are you nimble and alert to both risk and opportunity and the ever-changing nature of risk through the project lifecycle? Has a process for management to discuss this regularly with board members been agreed and accountabilities understood?
- Have specific actions or treatment plans relating to specific triggers of potential risks been agreed?
- Has your company developed a risk profile and fully determined your enterprise risk exposure?
- Do you assess and know your culture of risk appetite through example incidents? Directors can provide these to both board and management to test risk appetite throughout the organisation and highlight variances.
- Does the company have appropriate hedge cover for a range of scenarios such as interest payments?

# Comment from Rick Crabb, Non-Executive Chairman

Rick is a highly experienced company director with roles on numerous boards in the resources sector across a range of commodities and geographies. He has been the non-executive chairman of Platypus Minerals Ltd (formerly Ashburton Minerals Ltd) since 1999, Golden Rim Resources Ltd (since 2001), Otto Energy Ltd (since 2004) and Paladin Energy (since 2003). He is a councillor on the Western Australian Division of the Australian Institute of Company Directors. Rick was a solicitor from 1980 to 2004 specialising in mining, corporate and commercial law and has advised on numerous project developments in Australia and Africa.





Many people that I talk to in the resources and energy industry think that this is the worst environment we have seen since the 1980s. We have a combination of extreme difficulty in raising capital and low prices with volatility in most commodities. So for many companies at the small end, things have got appreciably worse since the last survey in 2013. Many companies have had to do very dilutive share issues at low prices in order to generate the cash to continue in business. If a company is a pure exploration company and is not committed to an exploration programme, then the board has the ability to defer activity. It will be interesting to see what activity levels exploration companies will be reporting, and whether we see a number of them delist. If a development has commenced or the company is in production, the choices are much more limited. Everyone is looking at cost reductions, but those companies often have to consider more drastic measures such as forced sales and mergers. Consolidation of shares and reduction of capital would not normally occur until there is an upturn.

What this has meant for many small and medium sized resources companies is a reduction in board size to reduce costs and, in many cases, a reduction of fees for remaining directors. Yet the work load for the board has generally been increasing because many of those companies are finely poised and decisions have a more significant impact than under more normal conditions. Other factors which are increasing the workload for larger companies are increasing focus on disclosure obligations and more involvement in strategy and risk.

At Paladin we take the view that risk sits with the board. We have an audit committee which deals with financial matters and advises the board on financial risk.

We also have a sustainability committee which looks at environmental risk and a compliance committee which deals with bribery and corruption. But it is essential that a collaborative approach is taken. So for example Paladin had to put one of its mines on care and maintenance during the year, and this involved a very detailed piece of work before a final decision was made to ensure we could manage the risks successfully and at the same time manage our relations with key stakeholders, such as government, employees and local communities, as well as our disclosure obligations. Directors have to be aware of what is going on so that disclosure is consistent and the company complies with its legal obligations. For example, analysts will often ask searching questions in investor briefings and it is important to deal with those in accordance with what has been disclosed to the market.

Where a board consists of four or less directors it can still be valuable to have committees dealing with these matters because it provides focus. But in small companies there is a great temptation just to deal with everything in the board. But one can consider ways of doing things which are quite practical. For example in one of the small companies I am a director of, which has only four directors, we have an audit committee of two directors. All directors are invited to its meetings, but some of its discussions are restricted to the members of the committee. The other directors are present for the rest of the meeting. This means they are informed of what the committee has considered rather than hearing it later. So this is a compromise which preserves having the separate audit committee, but reduces the amount of reporting and also ensures that all the board are fully informed.

“

The work load for the board has generally been increasing because many of those companies are finely poised and decisions have a more significant impact than under more normal conditions.

”

“The biggest challenges of corporate governance are to make it meaningful and engaging – as distinct from just following formulae – and having competent people to implement it. Competence requires the ability to see beyond a particular framework or regulation to impart the real purpose of the system.”

# Board structure

Structure, composition and skill set variety are important contributors to the quality of governance and the board.

We asked about key aspects of those elements, including board size, director independence, director share ownership, gender, board committees, meetings, approvals and framework documents.



# Findings

## Director numbers

The 2015 survey confirmed the result from 2013 - that director numbers tend to increase with market capitalisation, with no significant difference between mining companies and oil and gas companies – **Figure 3**.

Notwithstanding difficult economic conditions for these organisations, there appears to have been no major reduction in director numbers. In fact there was an increase in the number of small companies having four directors, with that remaining the most common board size for small companies. Five was the most common board size for medium companies. There was a significant reduction in medium companies having three directors. Seven was the most common board size for large companies.

## Independent Directors

The 2015 survey confirmed the result from 2013 - that the number of independent directors increases with the size of the company – **Figure 4**.

## Directors holding shares, options or performance rights

This was a new question in the 2015 survey. The results showed that in 39 percent of responding companies all directors held shares, options or performance rights in the company. For small companies the number was higher at 47 percent – **Figure 5**.

## Board size and skills

The survey asked respondents if they considered their board size optimal. It went on to ask about the number of independent directors and the perceived value they add and finally about the skill sets of the directors. Generally speaking respondents from large companies were comfortable with their board size, the number of independent directors and the skill sets of the board. Those from medium and small companies were less comfortable.

67 percent of respondents across all companies felt that the current board size was optimal for the current stage of the company. This percentage was highest for large companies (87 percent), as opposed to medium companies (65.5 percent) and small companies (62 percent). In large companies respondents were equally divided as to whether the board could be bigger or smaller. But with medium companies (24 percent) and small companies (27 percent) a larger proportion thought the board could be smaller.

A significant majority (80 percent) of respondents in large companies thought that the number of independent directors should stay the same, with no respondents thinking that they should decrease; the balance (20 percent) thought they should increase. The position of respondents in medium and small companies indicates less satisfaction with current board size and a significant proportion wanting more independent directors. 56 percent of respondents in small companies thought the number of independent directors should stay the same, 42 percent thought the number should increase and 2 percent thought it should decrease. For medium companies these percentages were 55, 35 and 10 respectively.

Across all companies 79 percent of respondents thought that independent directors added at least a moderate amount of value. Respondents in large companies had the highest percentage of those thinking that independent directors added a major amount of value (27 percent). 60 percent thought they added a significant amount of value and 6.5 percent that they added a moderate amount of value; only 6.5 percent thought they added only a minor amount of value. This contrasted with small companies where only 11 percent of respondents thought that independent directors added a major amount of value, 40 percent that they added a significant amount of value, 20 percent that they added a moderate amount of value and 20 percent thought they added a minor amount of value; 9 percent thought they added no value. Those thinking that independent directors added a minor amount of value or no value were most pronounced in explorers, where 28.5 percent considered that they added a minor amount of value and 9.5 percent that they added none. No respondents in producers or developers thought that independent directors added no value and only 11 percent thought they added a minor amount.

Across all companies, 71 percent of respondents thought that the skill sets of directors were optimal for the current state of the company. For large companies this figure was 87 percent, for producers 70 percent and developers 72 percent. The lowest percentage (64 percent) was for small companies.

If they considered that the skill set of the board was not optimal, respondents were asked to name the top three desired skill sets. Financial skills were among the three selected for each main category of company: large, medium, small, explorers, developers and producers.

Figure 3: Breakdown of directors by company size [all companies]

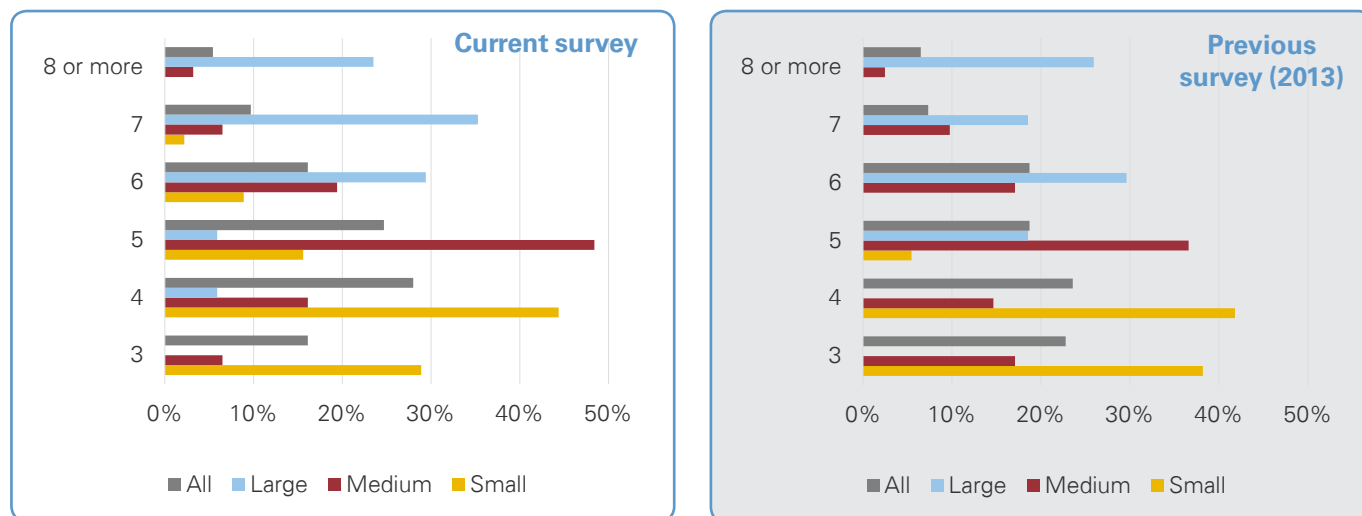


Figure 4: Number of independent directors by company type (for the purposes of the Annual Report)

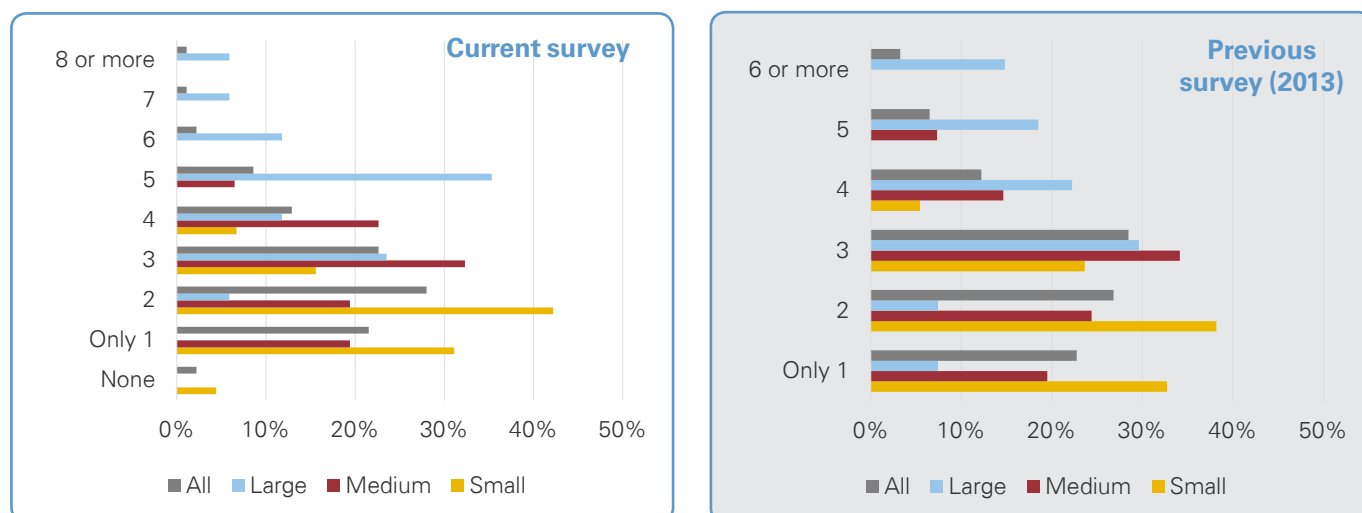
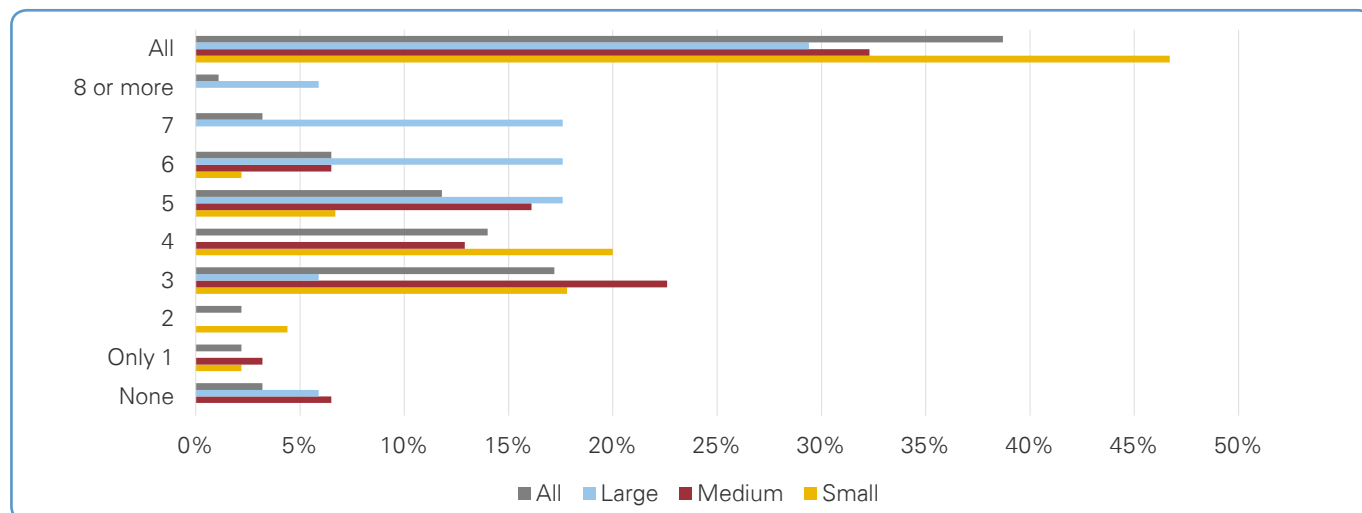


Figure 5: Number of directors by company type holding shares, options or performance rights





Other skill sets which rated prominently were:

- Capital markets skills (large, medium, small, explorers, developers and producers)
- Strategy skills (medium)
- Risk management skills (medium)
- Production skills (large)
- Marketing and sales skills (developers)
- Legal skills (producers).

## Gender diversity

The overall percentage of women in board roles among respondents was 22.5 percent, an increase from 16 percent in the last survey.

The increase was not spread evenly - but the overall trend was clear, as companies grow, so too does the number of females in board roles. At 13 percent the number for small companies was the same as in the last survey. In small companies there was generally not more than one female director. The percentage for medium companies increased to over 25 percent from 14 percent last time. Only 6 percent (two companies) had two female directors. While the percentage of large companies having female directors (41 percent) was close to the 40 percent in the last survey, there was an increase in those having two or three female directors (increasing from 10 percent to 23.5 percent).

Across all companies 47 percent had a gender diversity program, with that percentage being 70.5 percent for large companies, 58.5 percent for medium companies and 31 percent for small companies.

## Board committees

As with the last survey, the three most common committees were Audit (or Audit and Risk), Remuneration and Nomination – [Figure 6](#). In this survey we separated out Audit, Audit and Risk (that is an audit committee which deals with both audit and broader risk issues) and Risk. Our responses showed that across all companies Audit and Risk was the most common form of audit committee. However, the percentage of all companies that had one of these committees was 50.5 percent. 35 percent had an Audit committee and 11 percent had a Risk committee. Differences appear when the responses are viewed by size of company. 73 percent of large companies have a combined Audit and Risk committee, 55 percent of medium companies and 40 percent of small companies.

Taken across all companies, 65 percent had a remuneration committee and 38 percent a nomination committee - with these percentages increasing as companies move from small to medium and then

large. Over 80 percent of large companies have both a remuneration and a nomination committee.

Other committees which boards have include: health and safety, sustainability, disclosure and project steering.

## Issues for whole board resolution

The results for this survey confirmed the results of the last one - that most boards (over 80 percent) approve the annual budget, the strategic plan, finalisation of the annual accounts and executive remuneration – [Figure 7](#).

## Framework documents

Consistently across all companies, the most commonly used framework document is the board charter, with 95 percent of companies having one. This was also the result of our previous survey. 84 percent of companies had a code of conduct – [Figure 8](#).

## Board meetings and communication

Across all companies monthly board meetings remain the most common. 41.5 percent of respondents were also communicating as a board on a weekly basis. This is similar to the percentage in the last survey. 49 percent of respondents in small companies were communicating as a board on a weekly basis. 18 percent of respondents in small companies were communicating as a board every two to three days. In contrast no respondents in large companies were communicating that frequently, and only one respondent in a medium company. Respondents in large and medium companies who were communicating weekly were in the range 33 to 34 percent.

# Insights

## Board size and makeup

Since the last survey there has not been a significant shift in director numbers - certainly there does not appear to have been any significant downsizing of boards. Four directors remains the most common board size for small companies and five for medium companies. For large companies, the most common board size was seven directors, as compared to six in the previous survey. Nevertheless there were some differences of views amongst respondents, indicative of a desire for change. Approximately 25 percent of respondents from small and medium companies thought the board could be smaller. But over 33 percent of respondents from those companies thought that the number of independent directors should increase.

Figure 6: Board committees by company type

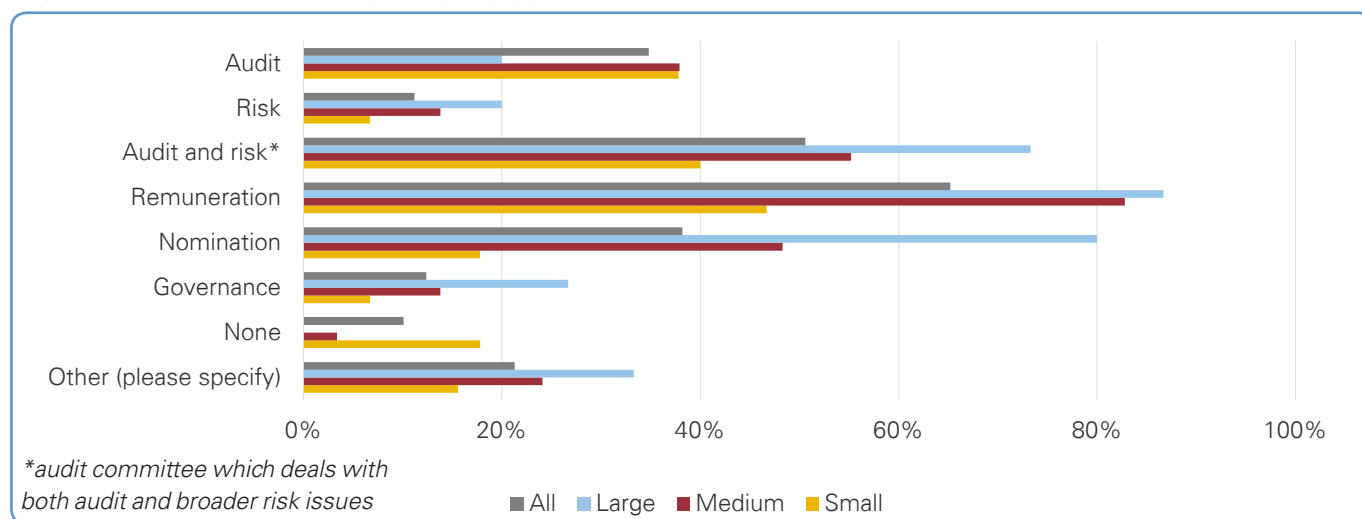


Figure 7: Which of the following issues does your company require to be approved by a resolution of the whole board?

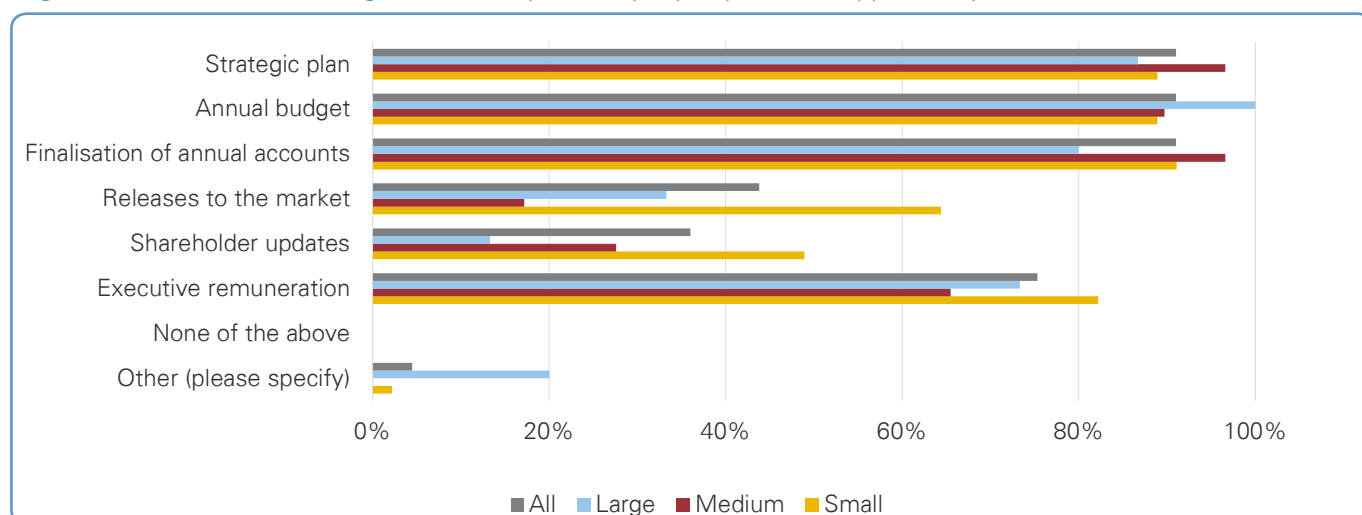
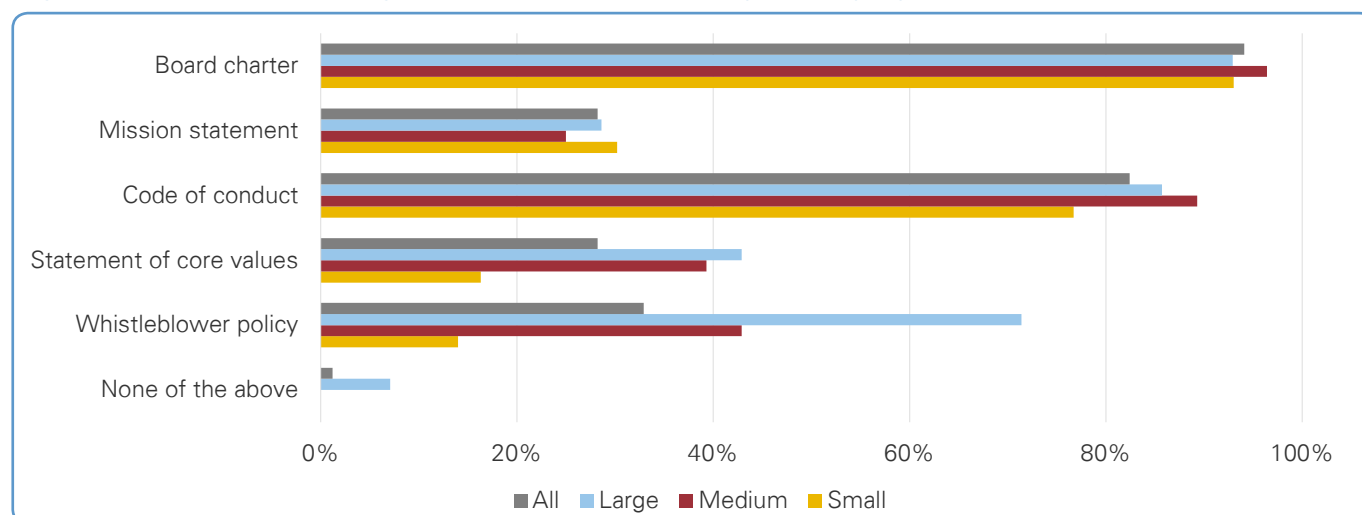
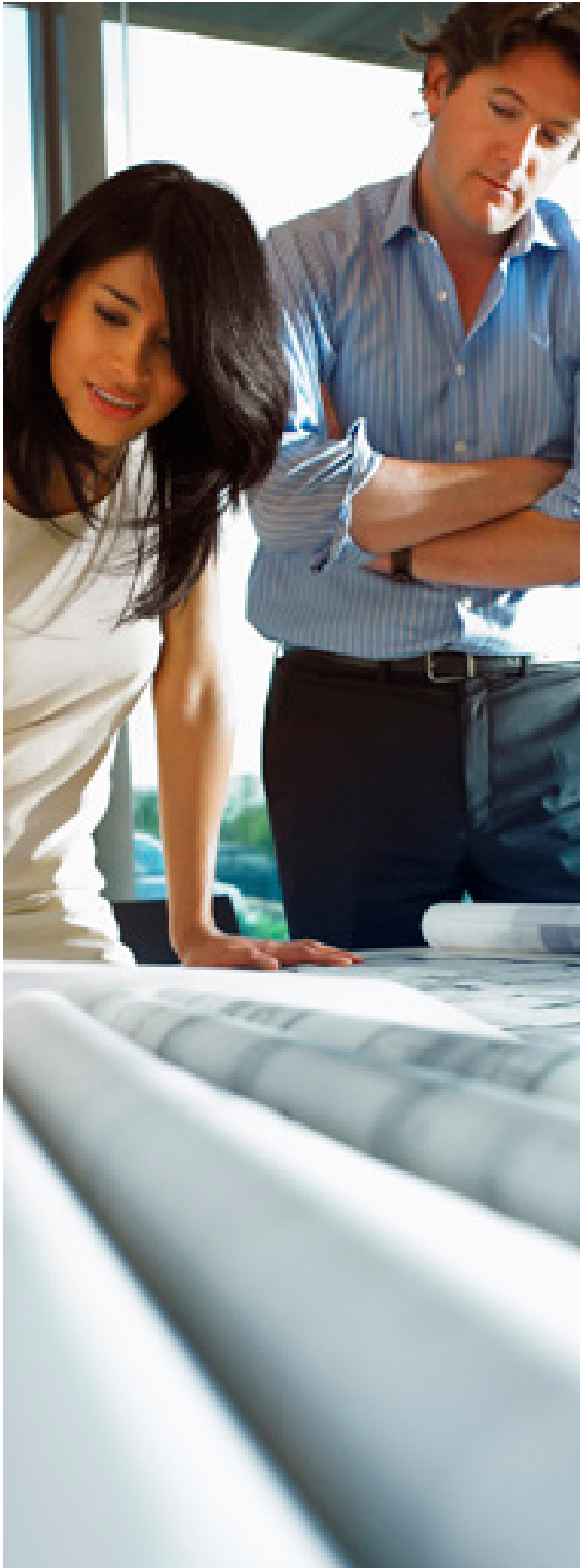


Figure 8: Which of the following framework documents does your company have?





There was a noticeable increase in the number of female directors in medium companies, with 25 percent having at least one female director (as opposed to 14 percent in the last survey). This had the effect of increasing the overall percentage of women in directorial roles for companies responding to 22.5 percent, an increase from the 16 percent in the last survey.

Interestingly, this is broadly in line with figures announced by the AICD at the end of March 2015 - that female directors in ASX 200 companies totaled 20 percent and 23 percent in ASX 100 companies.

The survey results continue to emphasise that the boards of large companies are structured differently from those of small companies. This can be seen in a number of ways: small companies have fewer directors, fewer independent directors, fewer female directors and more frequent meetings. Medium companies represent a transition point between the two. Many small companies do not follow the recommendations in the ASX Corporate Governance Principles about the number of independent directors required.

## Independence

In this survey we asked for the first time about the extent of the ownership of shares by directors and also asked respondents about the number of independent as opposed to non-executive directors. Share ownership (including options and performance rights) was at 39 percent of directors - and higher for small companies. The ASX Corporate Governance Principles (No 2) give examples of factors which are relevant to assessing the independence of a director. These include "being a substantial security holder of the entity or an officer of, or otherwise associated with, a substantial security holder of the entity". The commentary to that Principle states that independence is to be assessed by the board according to whether the director is "free of any interest, position, association or relationship that might influence, or reasonably be perceived to influence, in a material respect his or her capacity to bring an independent judgement to bear on issues before the board and to act in the best interests of the entity and its security holders generally". Although, as is pointed out by the ASX Corporate Governance Principles, share ownership may help to align the interests of a director with other shareholders, this is something that boards need to keep under review. To adhere to ASX Corporate Governance Recommendation 2.3 boards should disclose the names of directors considered to be independent and if a director holds shares then the board should provide an explanation why that does not compromise his or her independence.

# Considerations for Directors

The structure, composition and expertise of a board needs to be kept under constant review as the circumstances of the company change. Change can occur because the company grows, downsizes or undergoes other material changes. Growth commonly occurs as a company moves through the project cycle. Reduction commonly occurs because of lack of capital to fund exploration or because lower commodity prices mean that production is no longer profitable. As the last twelve months have shown, we live in particularly volatile times, so boards need to be prepared to respond to that volatility.

Matters to consider include:

- Do your meeting rules facilitate the calling of meetings on short notice and the use of electronic communication? This can be particularly important if directors are resident overseas, do a lot of travelling or visit remote regions, and need to be contacted urgently. Do your protocols deal adequately with the delivery of meeting materials and their security?
- Does your board have a process to review its framework documents and has the most recent review taken into account any new or overseas operations of the company, any reduction in the size or scope of operations and any change in the roles and responsibilities of the board or management? Has that review involved consultation with employees to ensure that key framework documents are clearly understood and can be implemented across the company? Have the delegations of authority and other supporting documents been brought up to date?
- Does your board have a nomination committee? If not, how and when is board composition reviewed?
- Has your company published a skills matrix for directors setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership (ASX Corporate Governance Principles Recommendation 2.2)? This would be critically important as the company moves through the production lifecycle, or refocuses to technology, given current circumstances.
- Do board committees have similar and systematic planning, with an annual agenda which links into the board's annual agenda?
- Do you think your directors and especially audit committees need to spend more time on risk oversight – particularly cyber security and the pace of technology change?
- Do you work with management to define or refine the audit committee's (and board's) information needs? Does this process recognise when asymmetric risk – the over-reliance on senior management's information and perspective – is too high, and seek out independent sources of information and perspective?
- Have you considered whether the board needs to recalibrate how its committees communicate and coordinate on risk oversight? Are committee chairs communicating regularly to ensure they understand what is going on in the other committees?
- Leading organisations have strategic risk functions which identify emerging trends, longer-term opportunities and risks to help drive performance and resilience. They ensure that the accountability for continual identification and management of business risks is embedded within the first line of defence (e.g. management) with clear escalation mechanisms. They understand the power of 'conscious risk taking' within the boundaries of the defined risk appetite model of the business. Is this the manner in which your company is operating? If not, why not?

“Very small companies often do not have improvement of their corporate governance systems at the top of their mind – survival is the focus. Quieter times present an opportunity to work on their position, have scaleable policies in place, ready for future growth.”



# Reports and indicators

In order to discharge their responsibilities, directors need access to accurate, timely and relevant information to make decisions and assess performance.

We asked about the most common reports produced for the board and the indicators used to measure performance.



# Findings

## Reports

**Figure 9** shows the most commonly produced reports for board meetings are the financial performance report, (91 percent across all companies) CEO report, operations report and health and safety report. Market capitalisation affects which other reports boards require. Only 73 percent of large companies have a CEO report (as compared with 84 percent of small companies and 89.5 percent of medium companies). 100 percent of large companies have a health and safety report (as compared with 47 percent of small companies and 76 percent of medium companies).

It is interesting to note that responses indicate that the boards of all large companies now get a financial performance report, operations report and health and safety report. In the 2013 survey between 90 and 97 percent of large company boards received them.

**Figure 10** shows that the focus on operations and health and safety increases as companies move through the project cycle (78 percent of the boards of developers and 92.5 percent of producers receive an operations report, and 67 percent of the boards of developers and 81.5 percent of producers receive a health and safety report) but also with an increase in market capitalisation. The boards of 62 percent of small companies receive an operations report, as compared with 93 percent of medium companies and 100 percent of large companies.

## Use of Indicators

**Figure 11** shows the types of indicators measured across companies and reported to the board, with current financial performance and performance against budget the most common.

Again the use of certain indicators increases as companies move through the project cycle and increase their market capitalisation, with emphasis changing as these things occur. 82 percent of small companies measure current financial performance and report it to the board, but they are less likely to do it in the context of a strategic plan or budget (35.5 percent measure performance against strategic plan and 58 percent against budget).

For medium companies the use of performance against budget increases to 90 percent. Other indicators are also used to a greater degree at this stage, including operational performance (79 percent), time lost through injuries (72 percent) and accidents, environmental damage and near misses (62 percent).

When the market capitalisation of companies reaches the large level, all companies measure performance against budget and accidents, environmental damage and near misses. Operational performance is measured by 80 percent of large companies and time lost through injuries by 93 percent. Measuring project development costs and project performance also increases with market capitalisation.

As you would expect, there are also differences in emphasis between developers, producers and explorers. Developers have a greater emphasis on project performance and project development costs than producers, with 72 percent of developers measuring project development costs, 61 percent measuring project performance and 44 percent measuring operational performance. 48 percent of producers measure project performance and project development costs, but 96 percent measure operational performance. 48 percent of explorers measure project performance, and accidents, environmental damage and near misses and 43 percent measure operational performance.

Small companies, perhaps because of their need to raise capital, at 53 percent have a higher focus on measuring compliance with stock exchange listing rules than most other companies. The group which measures this the most is explorers at 62 percent.

Figure 9: Types of reports produced for board meetings (split by company size)

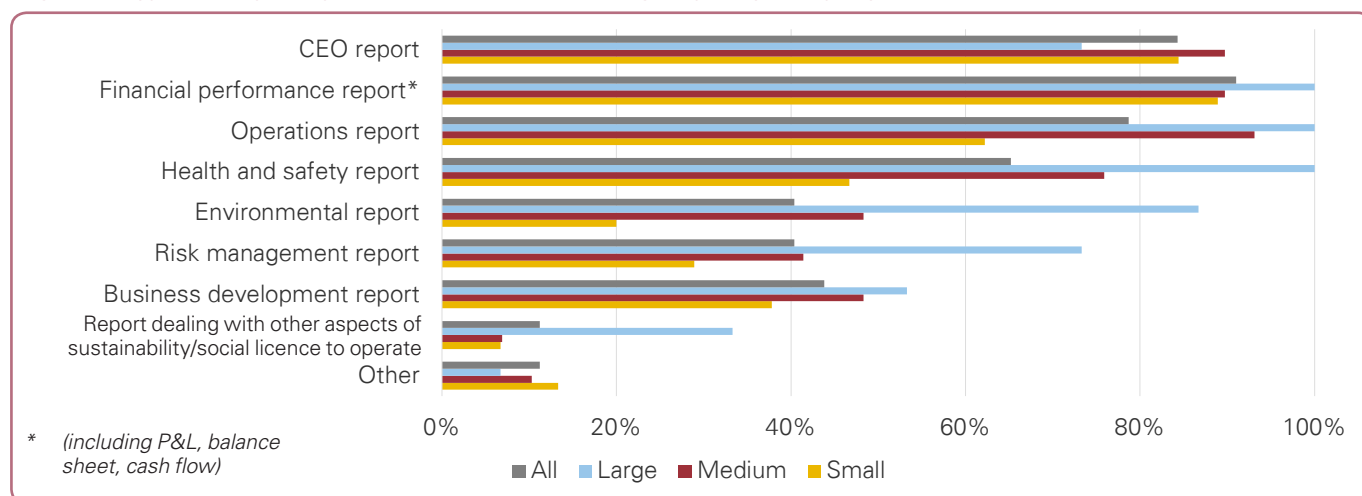


Figure 10: Types of reports produced for board meetings (split by company type)

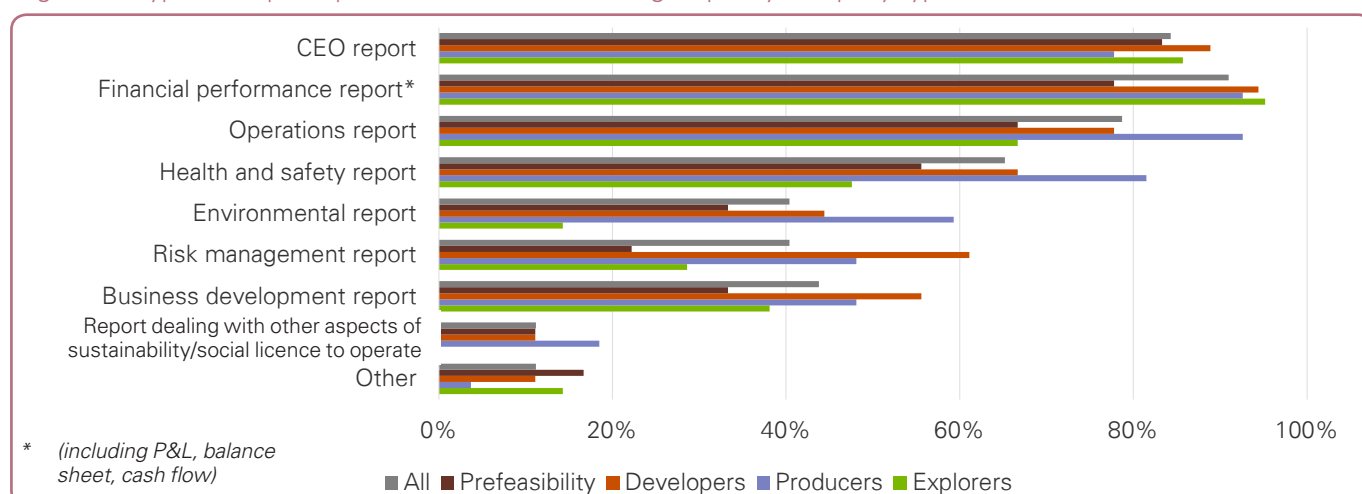
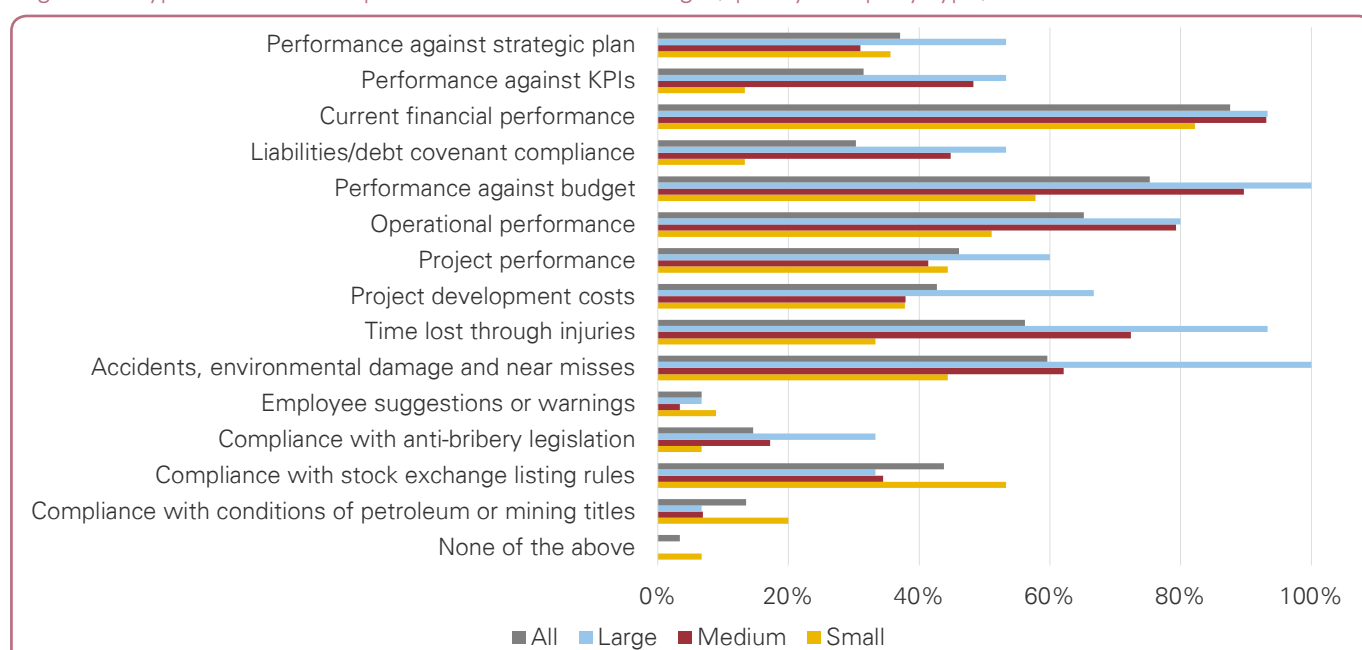


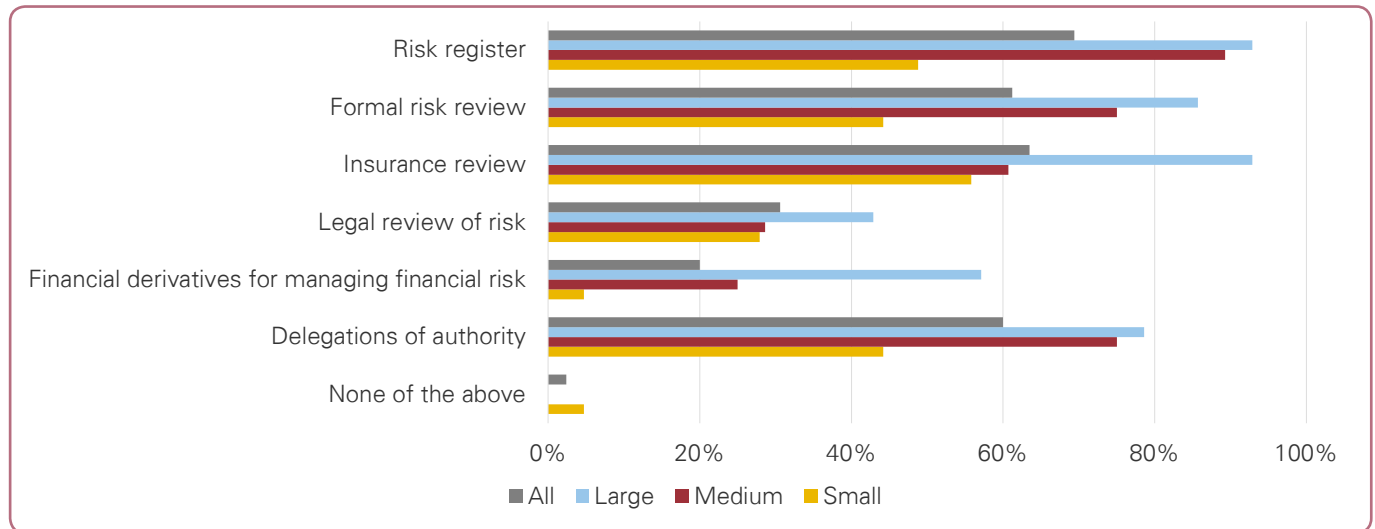
Figure 11: Types of indicators produced for board meetings (split by company type)



## Which risk management tools do companies use?

Most companies maintain a risk register (69 percent). Over 60 percent had a formal risk review and insurance review and delegations of authority – **Figure 12**.

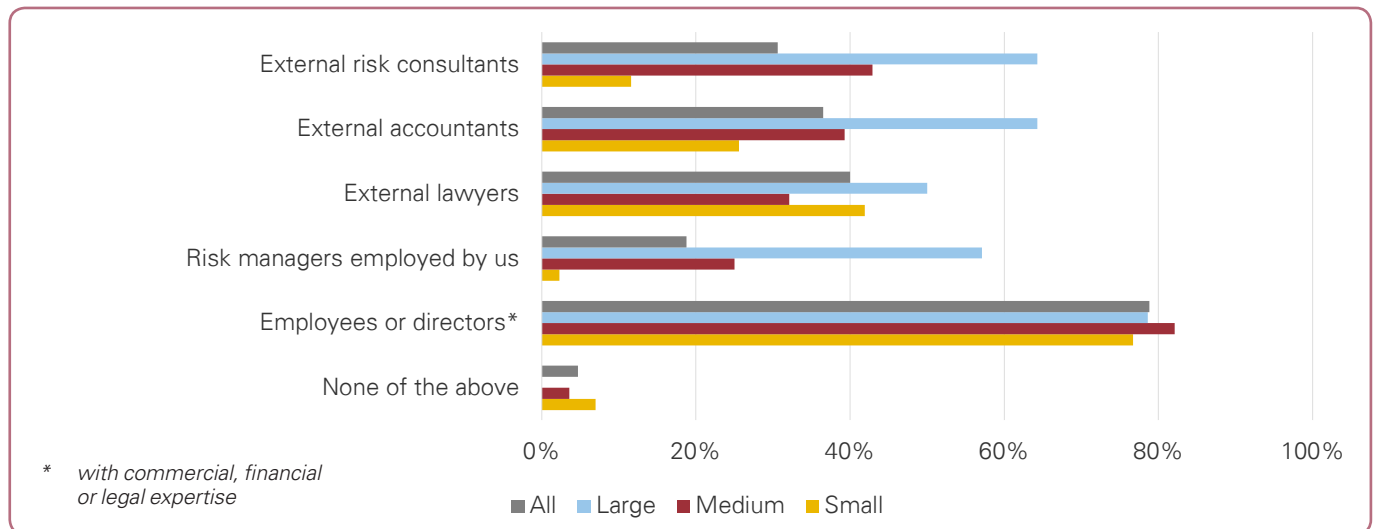
Figure 12: Risk management tools



## What advice do companies take on risk?

The significant difference in **Figure 13** is the disparity between large companies and other companies in employing risk managers and engaging external risk consultants and external accountants.

Figure 13: Advice on risk



## Insights

The responses show that companies increase the reports that the board gets and the indicators measured as the company evolves and grows. A main focus of all companies is the financial performance report. But going beyond that small companies are more reliant on the CEO's report and, to test information and strategy, on presentations by company executives. Fewer small companies than medium or large companies obtain an operations report or health and safety report, or have indicators that measure those areas. By the time that a company's market capitalisation becomes large, the board will be receiving both operations reports and health and safety reports. As market capitalisation increases so does the emphasis given to health and safety reporting.

The challenge for directors of small companies is to work out when the board should be tracking operations and health and safety to a greater degree, and how to do so when they do not have employees with the requisite skills. The liability issues in relation to health and safety are such that it is an area that directors must be able to show that they have taken a high degree of care.

This is a matter that directors of large companies tend to take very seriously, albeit they are normally in a position to get reports in this area and also to measure performance because they have chosen indicators. But even in large companies there is a high degree of reliance on presentations by company executives as a means of testing the information received. 40 percent of large companies test information through presentations by external experts (as compared with only 29 percent of small companies). 60 percent of large companies receive business risk updates (as compared with 27 percent of small companies).

In light of the desire for directors to have a sound, first hand, appreciation for the operations and related risks and opportunities, there is increasing pressure for directors to personally visit operations. Cost can be a factor here, particularly if the company has overseas operations. Directors generally need to consider the purpose and value of visiting operations. If the purpose is to experience safety conditions and get a sense of whether the operations are well run, is that a task that is best delegated to a group of directors with the requisite skills or an external consultant? Small companies may be able to make use of a similar approach or require their contractors/consultants to provide reports.

Historically, share options have been used as an incentive by organisations who wish to attract high calibre directors or expand the skill sets of the board, but have limited cashflow. We anticipate that a higher proportion of organisations will use options in this way so as to be able to continue to access and appropriately remunerate directors in the continuing cash conscious environment.

## Considerations for Directors

It is an ongoing challenge for directors to obtain timely and relevant information.

Matters to consider include:

- Whether management are ready to provide information relevant to the next stage of the company's activities - for example if the company is developing its first project, is it ready to measure the costs of development? If it has not developed a project for some time, does it still have the capability to do it? - What changes have occurred in available software or internal reporting which need to be taken into account?
- Does the board have the capability to interpret the new flow of information?
- Is there information being produced for management purposes which can be copied to the board as a means of keeping directors informed?
- Who has the responsibility for informing the board of potential gaps in reporting and ways to improve reporting?
- Is there a system of peer or other review of these processes so that they are regularly updated and subject to external scrutiny?
- Does the quality of information about cyber security and technology risk, talent, innovation, and business model disruption needs to improve to ensure these evolving risk receives the necessary focus?
- Ultimately, the future of risk management lies in maintaining the prevention mind set, but extending the function towards value creation through a more holistic approach. Creating a conscious risk taking environment where everyone understands what risks to embrace and how to fully leverage the risk management investment will deliver a far better outcome than a simple focus on prevention. Is this how your company is operating? If not, why not?

“ A robust corporate governance culture is best achieved through the mindset of the board. A good corporate culture rewards and encourages good conduct. A poor corporate governance culture often results in poor conduct and the loss of confidence and trust in our Australian market.”



# Disclosure

Under Listing Rule 3.1 a listed entity must immediately notify the ASX once it becomes aware of any information concerning it, that a reasonable person would expect to have a material effect on the price or value of the entity's securities. The ASX Corporate Governance Principles (No 5) say that companies should establish and disclose written policies and procedures to ensure compliance with the disclosure requirement and to ensure senior executive accountability.

We asked who is responsible for preparing announcements and what controls directors have over them. We also asked about disclosure in the annual report of measurable goals and indicators.



## Findings

Our results show that CEOs and company secretaries are actively involved in managing continuous disclosure and the preparation of announcements, with the whole board taking a large role in approving announcements to the market. This is irrespective of the project phase or market capitalisation.

### Who prepares the announcements?

**Figure 14** shows that in most companies it is the CEO or the company secretary who prepares announcements. In the last survey we learned that this is often a shared responsibility, particularly in small companies. In this survey the question was framed to allow the selection of both the company secretary and the CEO, and the results indicated that it continues to be a shared responsibility across many companies. However, there seems to be clearer delineation in large companies, with the company secretary more often having the primary responsibility for preparing announcements. But others can become involved, including the exploration or production manager, the person responsible for investor relations, the COO, the CFO or a continuous disclosure committee, if the company has one - and the matter warrants it.

### Who is responsible for managing continuous disclosure obligations?

The results show that the CEO and the company secretary most commonly have the responsibility for managing continuous disclosure – **Figure 15**. As with the preparation of announcements, this is often a shared responsibility between them. However, taken across all companies, in over 25 percent it is the responsibility of the whole board, a committee of the board or nominated directors (perhaps in the form of a continuous disclosure committee, which is a management committee rather than a board committee).

### Whose approval is necessary for announcements?

For most companies, the CEO or the company secretary has to give approval for an announcement to be made to the market – **Figure 16**. In a lesser number of companies the whole board has to approve an announcement. This is more likely to be the case in a small company, in which 60 percent of respondent companies required the approval of the whole board for an announcement to be made. This compares with 17 percent of medium companies and 40 percent of large companies.

Interestingly, 27 percent of medium companies require the approval of one or two directors, as compared with 33 percent of large companies and 9 percent of small companies. Unsurprisingly small companies (at 84 percent) have the highest percentage giving all directors the opportunity to comment on announcements before they are issued. This compares with 65 percent for medium companies and 60 percent for large companies. About 30 percent of both large and medium companies give some directors the opportunity to comment. This compares with 15.5 percent for small companies.

Comments were made by those who responded by saying that other approvals were necessary. What these comments generally reflected was that the company had a process for determining whether something was so significant that the whole board needed to be consulted (for example a disclosure committee).

### Annual Report Disclosure

We asked whether the company's annual report contained measurable financial goals and key performance indicators with an annual update as to progress in meeting them. We also asked companies whether their annual report contained measurable corporate responsibility and sustainability goals and key performance indicators with an annual update as to progress in meeting them.

As expected, positive responses from larger companies to these questions were significantly higher than from medium and smaller companies. 40 percent of the large company respondents indicated that they provide measurable financial goals and key performance indicators in the annual report. Similarly, 43 percent provide measurable corporate responsibility and sustainability goals and key performance indicators with an update on progress achieved. The levels of positive responses from medium and smaller sized companies were significantly lower. 14 percent of the medium companies and 18 percent of small companies provide measurable financial goals and key performance indicators in the annual report. However, the proportion of these companies that provide measurable corporate responsibility and sustainability goals and key performance indicators and annual updates as to progress achieved was considerably lower at around 6-8 percent.

Figure 14: Responsibility for preparing announcements to the stock exchange

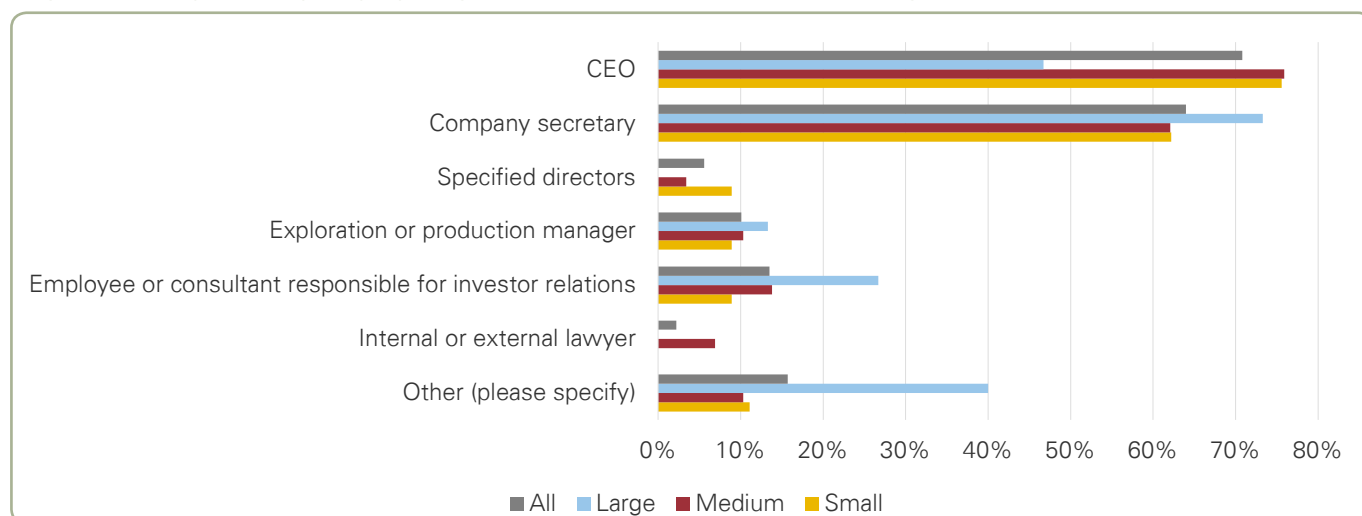


Figure 15: Responsibility for managing continuous disclosure

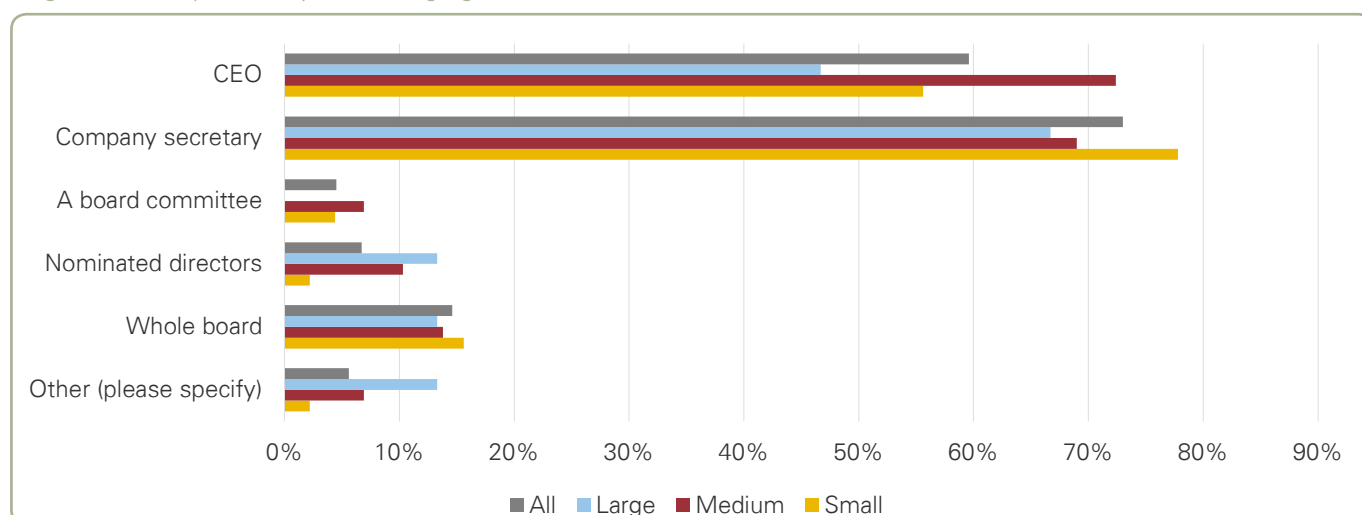
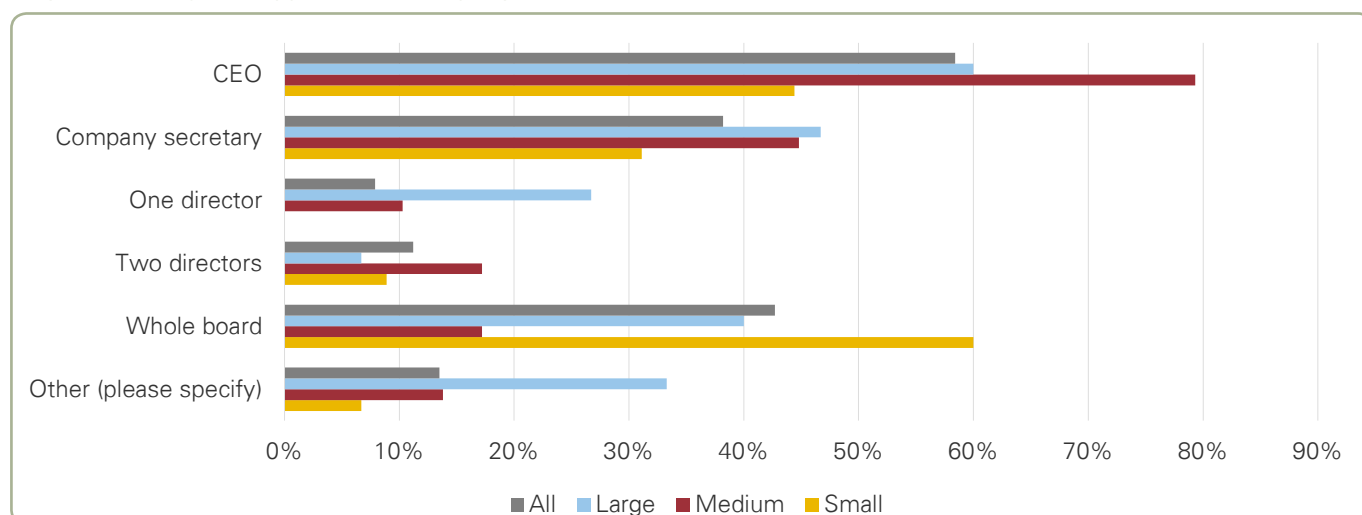


Figure 16: Required approval for company announcements



# Insights

## Managing the Continuous Disclosure Process

CEOs and company secretaries are mainly responsible for preparing announcements and managing continuous disclosure. How boards get involved varies significantly according to the size of the company. 84 percent of small companies give all directors the opportunity to comment on announcements before they are made and 60 percent require board approval for an announcement to be made. These percentages are much lower for medium and large companies. Quite commonly those companies give a director or group of directors an oversight role in relation to disclosure. With a small company it is quite likely to have a small board (say 3 or 4 directors), all of whom are closely involved in the company and its operations, particularly if it is still at the exploration stage. Unless an unusual event occurs, such as a takeover, it would not be difficult for the board, acting as a whole, to be closely involved in the disclosure process. This becomes more difficult as the company progresses through the project cycle, its operations grow in size and regional diversity and the size of its board increases. Questions can then start to arise as to when it is appropriate to ask all directors to review a possible announcement.

Differences of view can also emerge on matters like materiality and the timing of disclosure. Some corporate executives suggest they are reluctant to continuously disclose matters, particularly while some of the relevant details and consequences are uncertain, with this preference often framed as a liability issue. These commentators suggest that it is better to defer disclosure until the outcomes are fully understood. However, this approach, which suggests materiality is dependent on certainty, is inconsistent with the continuous disclosure obligations and the skills and experience of business people, investors and legal practitioners.

## Measurable goals in the annual report

40 percent of large companies, 14 percent of medium companies and 18 percent of small companies provide measurable financial goals and key performance indicators in the annual report. The fact this number is low is not surprising, given that there is no regulation presently in Australia that mandates the provision of measurable financial goals and key performance indicators or the inclusion of performance tables in the annual report. Further, there is no regulation that requires companies to disclose measurable corporate responsibility and sustainability goals and metrics, or updates on progress achieved against such goals and metrics. The companies that provide these classes of information do so voluntarily in response to demands from investors and other stakeholders. The results of this survey indicate that a sizable minority of mining and energy companies in Australia are providing some financial goals and key performance indicators in their annual report.

Reviews of corporate periodic reports over the last three decades found that some company reports and websites provide clear, concise and effective discussion of developments over the prior two years, but many fail to explain the company's longer term "story", including its prospects and dreams<sup>1</sup>. Indeed, critical questions concerning the creation of long term value are often not addressed at all, or are poorly explained, within corporate reports in Australia (and elsewhere). Many companies fail to publicly explain the drivers (i.e. the "how" and "why") of their results and performance within the periodic reports and disclosures. Moreover, commentary that explains the company's strategies, plans, risks and opportunities, its financial and non-financial targets, and how it is faring against these plans and targets is often lacking. These trends are surprising, especially across the resource sector that requires new sources of capital and patient investors.

<sup>1</sup> Gill North, *Corporate Communication in the 21st Century* (Kluwer Law International, the Hague, 2015 forthcoming); Gill North, *Company Disclosure in Australia* (LawBook Co, Sydney, 2013)

“

Unless all directors are going to review all potential announcements to the market, someone has to make a judgement in a company as to whether a possible announcement is sufficiently important for all the directors to be consulted. At the company, this is done by the CEO, the company secretary and myself as Chairman working together.

”

“

I find that the time involved in reviewing announcements varies significantly between companies. Take Quarterly Reports for mining or energy companies. Some companies treat them as purely formal reporting of tonnages, grades etc. Although the board will get to see them before they are released there will normally be very little input from directors. Other companies use them as a general update on things like the progress of a capital project, mine cost trends and so forth. In those cases some or all board members could be closely involved in reviewing the report before it is released.

”

## Considerations for Directors

It is essential for companies to have an effective process to manage disclosure, and also a clear approach as to what performance measures they want to disclose voluntarily, for example, in their annual report which can clarify for investors how the company is faring.

Matters to consider include:

- What process does your board have to decide what is a routine disclosure which is unlikely to be important or sensitive as opposed to something which is sensitive or important or both?
- How are issues like materiality of an event in relation to the price or value of the company's securities decided? Do the persons responsible for managing disclosure in the company have a shared understanding with the board of what is likely to be material?
- Has your company's responsiveness to the occurrence of material events ever been tested? What lessons were learned and were changes made?
- Is it part of your process for negotiating transactions to work out what should be done if news of the possible transaction leaks to the market?
- Does your company have a system or processes in place to determine what is significant to require all the board to be consulted?
- Does the board consider corporate responsibility and sustainability - if so, are appropriate systems and processes in place to provide the desired information? If this is not dealt with currently, has it been agreed as to when these topics will be reported and do you have appropriate indicators in mind to respond?
- Have you discussed how liability influences this process?

## Comment from Jane Gouvernet, WA Regional Commissioner, ASIC

Jane was appointed Senior Executive – Emerging, Mining & Resources on 16 December 2013 and WA Regional Commissioner on 29 January 2014. Jane has spent her professional life working predominantly in the WA market in a regulatory capacity, including in a number of senior ASIC positions within the markets enforcement and strategy teams. Prior to working at ASIC, Jane consulted to the Rothwells Taskforce, worked with the London Stock Exchange, The Securities Association and the Australian Stock Exchange in both Perth and Sydney. Jane is a graduate member of the AICD and FINSIA.





In the equivalent publication in 2013, ASIC's former Regional Commissioner of WA, Bruce Dodd, said it was a challenging time for resources companies. This was particularly true for mining exploration companies.

These times have continued and capital has become increasingly difficult to obtain. A fall in commodity prices has meant many producers are seeking further efficiencies. Many smaller resource companies have sought alternative opportunities which have been found in the technology sector.

A change in business activities means a change in governance. Outdated policies and practice may lead to unreliable financial reporting systems, poor disclosure management, and risks that remain unidentified, unmanaged and therefore unreported.

Directors should regularly review an entity's corporate governance policies and practices to ensure they are aligned with the entity's operations and the changing environment.

Globalisation of markets, including increasing international interests, brings with it new issues for our resource sector. Many resource entities have strong connections to emerging markets because of the location of their assets, operations, management or shareholder base.

To maintain investor confidence in an organisation and in our markets, it is important directors consider the difficult issues around emerging markets.

An ASIC review in 2013 highlighted areas of concern for emerging market interests, including:

- Governance standards, particularly internal control and risk management systems
- Location of key individuals overseas
- Complex ownership structures or contractual arrangements which complicate the transparency required by Australian laws on ownership and control
- Difficulty in obtaining verifiable information or opinions about overseas operations and performance
- Audit quality, particularly of work of foreign auditors.

To minimise or mitigate risks presented by geographical and cultural spread, ASIC suggests entities review their corporate governance to ensure:

- Disclosure policies account for the challenges and impact emerging market locations may have on management of confidential information as well as timely disclosure
- Risk processes identify preventable difficulties in operating in foreign jurisdictions

- Corporate reporting processes maintain the standards in the Corporations Act and listing rules. This includes ensuring directors and entities comply with substantial holding obligations. Auditors should also closely review an entity's foreign audit report to discharge their obligations. This may require direct audit evidence attesting to the existence and value of underlying assets and operations.

The slowdown in the mining sector has also seen emerging market entities use a reverse merger or 'backdoor' process to gain an Australian listing. Technology is a common type of business being sold into Australian listed entities and this has presented entities with new corporate governance considerations. For example, does the board, particularly any new members, have the skills, knowledge, experience, independence, diversity and familiarity with the entity, its new business, and listed status? Professional development of management may be necessary to help the board discharge its responsibilities and duties.

Board independence is often a challenge for small companies, but is important to ensure an individual does not dominate decision making and that board decisions reflect the best interest of the entity and its shareholders.


Before a backdoor listing, a board's risk review should also extend to post backdoor listing risks. All material risks should be included in the backdoor listing disclosure documents. Disclosing material risks are critical to providing investors with the information required to make an informed investment decision. Failure to manage risks can materially erode an entity's value.

For example, cyber-risks may be particularly relevant for entities that have a new business focusing on technology. A cyber-attack can result in loss of confidential information and a significant disruption to business which may erode value. New technology entities should consider this risk and whether they have any necessary policies to respond to the contingency of a cyber-attack so as to limit loss and quickly recover operations.

ASIC urges directors not to think of corporate governance as mere compliance. A robust corporate governance culture is best achieved through the mindset of the board. A good corporate culture rewards and encourages good conduct. A poor corporate governance culture often results in poor conduct and the loss of confidence and trust in our Australian market.

“Corporates and their directors need to get used to it being “lower for longer”. There is real value in analysing scenarios that may feel improbable at the time.”

# Business practices and related policies

A photograph of three men in business attire. On the left, a man in a dark suit and blue tie looks towards the center. In the middle, a man in a light purple shirt and dark tie points his right hand towards the right. On the right, the back of a man in a blue shirt is visible as he looks towards the man in the purple shirt. They are standing in front of large glass windows that look out onto an industrial facility with yellow structures.

Corporate governance comprises the systems and practices. How corporations determine what is acceptable or unacceptable behaviour and how they reinforce integrity, honesty, trust and accountability are important in achieving good practices. Those practices need to be seen against a background of increasing emphasis on corporations behaving in a sustainable and socially responsible manner, and also increasing disclosure requirements (ASX Corporate Governance Recommendation 7.4).

We asked respondents to rank various corporate governance practices and asked for their views on ethical behaviour.

# Findings

## Practices considered important

We asked respondents to rank the three most important governance practices. Across all companies, the three most important were occupational health and safety, risk management and effective engagement, communication and reporting to shareholders. There was no significant variation in the responses between companies of different market capitalisation.

We then asked respondents which practices they felt their company did well – **Figure 17**. Across all companies the three practices which most respondents thought they did well were: engaging stakeholders (70 percent), encouraging socially responsible behaviour amongst all employees (56 percent) and promoting a strong understanding of ethics (49 percent). Next was creating an environment where all employees can voice concerns about unethical behaviour by directors or senior executives (36 percent). Setting clear accountabilities for unethical or socially irresponsible behaviour was at 33 percent.

Market capitalisation affected the responses in some areas, most markedly encouraging socially responsible behaviour and setting clear accountabilities for unethical or socially responsible behaviour. Respondents in large companies assessed their companies more highly than respondents in small and medium companies in both of these. 71 percent of respondents from large companies rated their company as doing them both well as compared to small companies (49 percent and 23 percent) and medium companies (61 percent and 29 percent). What is also interesting, is the strong difference in setting clear accountabilities, which was much lower in small (23 percent) and medium (29 percent) companies - possibly indicating that only large companies have developed policies in these areas which set out accountabilities. Across all companies the number of companies thinking that they did well at obtaining independent assurance of these matters was only 9 percent.

Respondents in small and medium companies assessed their companies at doing best in engaging stakeholders, where they were in the range 71 to 72 percent (as compared with large companies at 64 percent).

## The state of ethics in business

Across all companies, 40 percent of respondents thought that the ethical standards of those their company deals with had improved in the last 5 years. 55 percent thought that they had stayed the same.

Only 5 percent thought they had got worse – **Figure 18**. In large companies a higher percentage (64 percent) thought that ethical standards had improved in the last 5 years, as compared to small and medium companies, which were about 35 percent, explorers which were at 48 percent, developers at 47 percent and producers at 31 percent.

## Good faith in major contracts

Across all companies 40 percent of respondents were prepared to agree in their major contracts that the company would act in good faith, 40 percent were prepared to agree that the company would act reasonably and 7 percent were prepared to agree that their company would deal fairly – **Figure 19**. Only 12 percent resisted those kinds of contract terms, but would give them if necessary, and only one percent would refuse to give them. In this survey we framed the questions so respondents could only select one answer, whereas in the previous survey respondents could select multiple answers. In that survey 50 percent of respondents said that they were prepared for their company to agree that the company would act in good faith and a little over 20 percent that the company would act reasonably. One of the reasons we framed the question differently this time was that we were surprised at the dominance of the preparedness to agree to act in good faith, which is a more onerous standard than acting reasonably. Nevertheless, a significant proportion (40 percent) of companies are prepared to do that. Only a small proportion resist these kinds of terms. The group with the highest percentage of those prepared to agree to act in good faith were explorers (57 percent), followed by small companies (44 percent), producers (42 percent), medium companies (39 percent), large companies and developers (both at 29 percent).

## Measuring corporate responsibility and sustainability

Across all companies the annual report of only 13 percent of respondents contained measurable corporate responsibility and sustainability goals and key performance indicators, with an annual update as to progress in meeting them – **Figure 20**. The results varied significantly by market capitalisation; 43 percent of large companies provided this information, but only between 6 and 8 percent of medium and small companies.

Figure 17: Practices which companies consider they do well

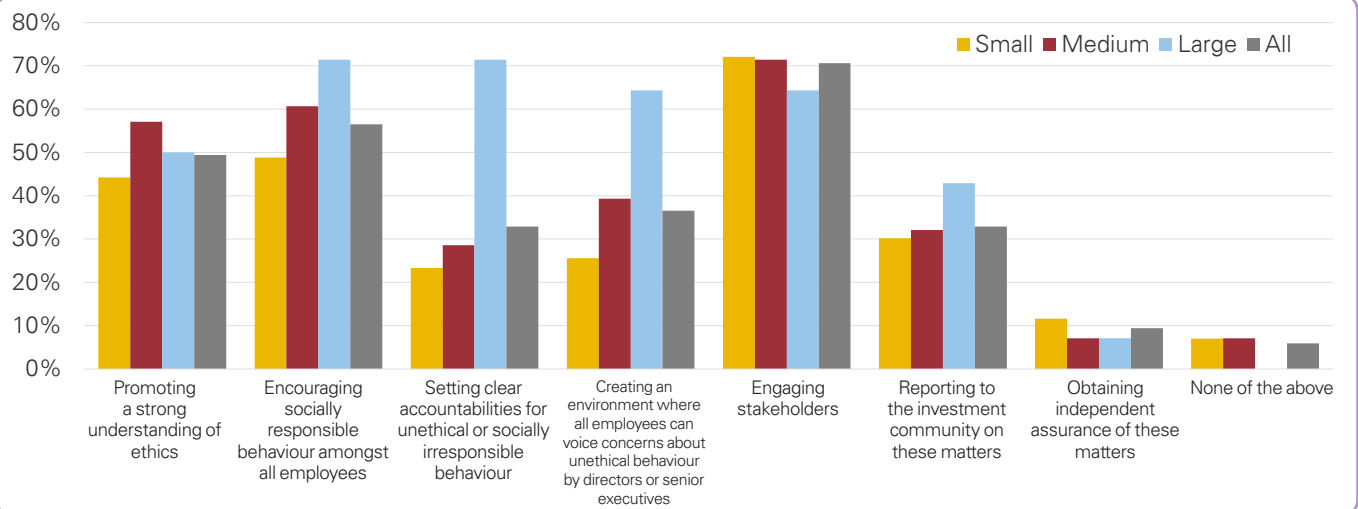


Figure 18: Ethical standards of those your company does business with

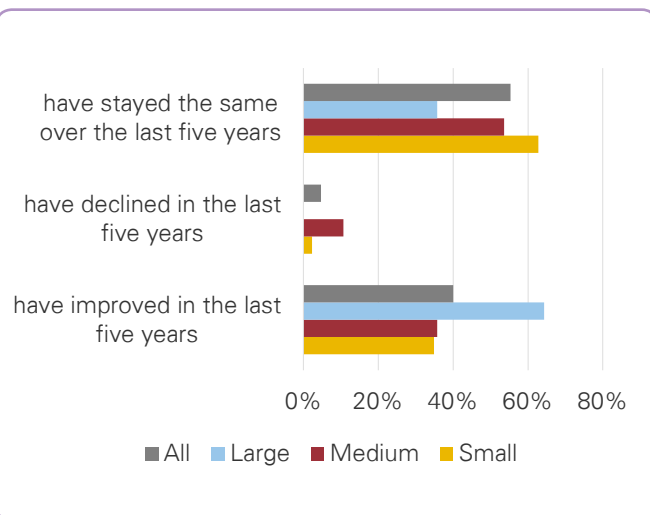


Figure 20: Annual reports containing measurable corporate responsibility and sustainability goals and KPIs

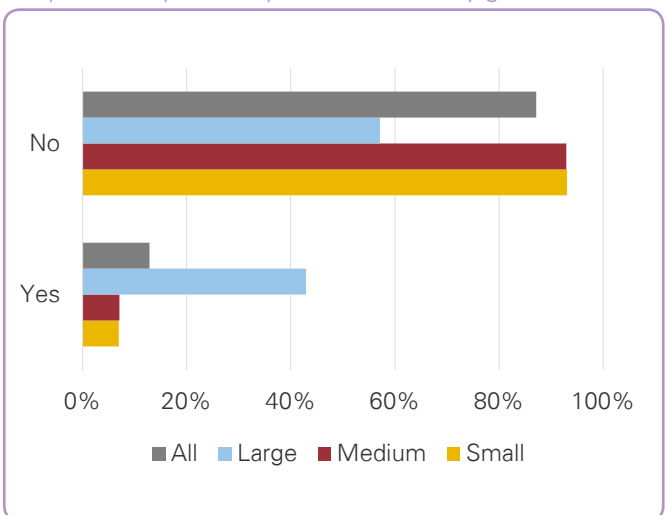
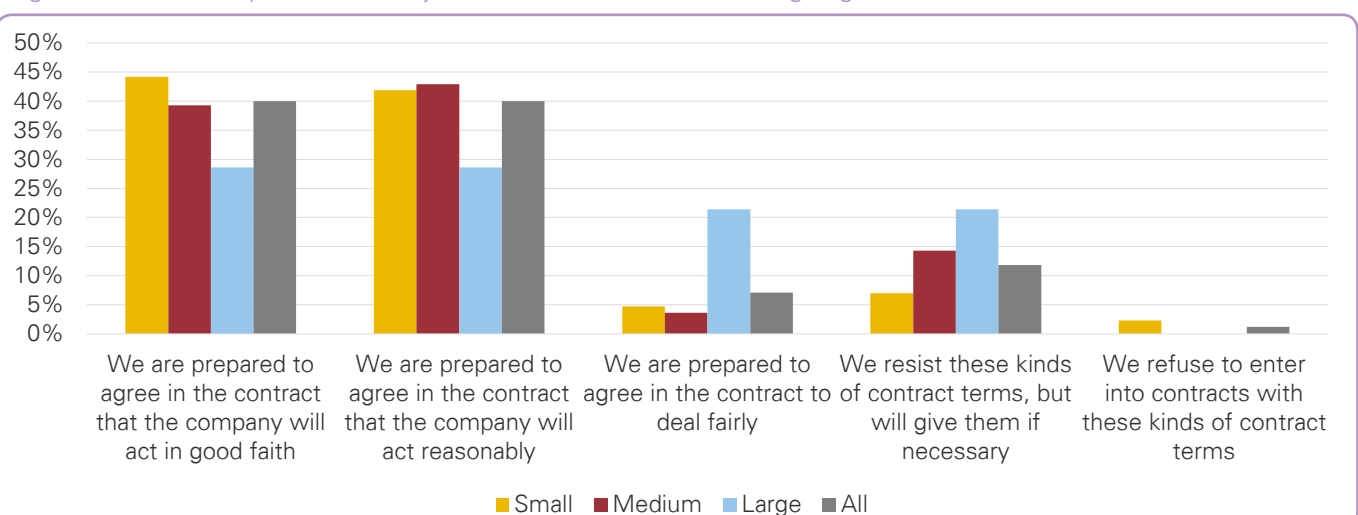


Figure 19: Preferred position on major contracts in relation to acting in good faith



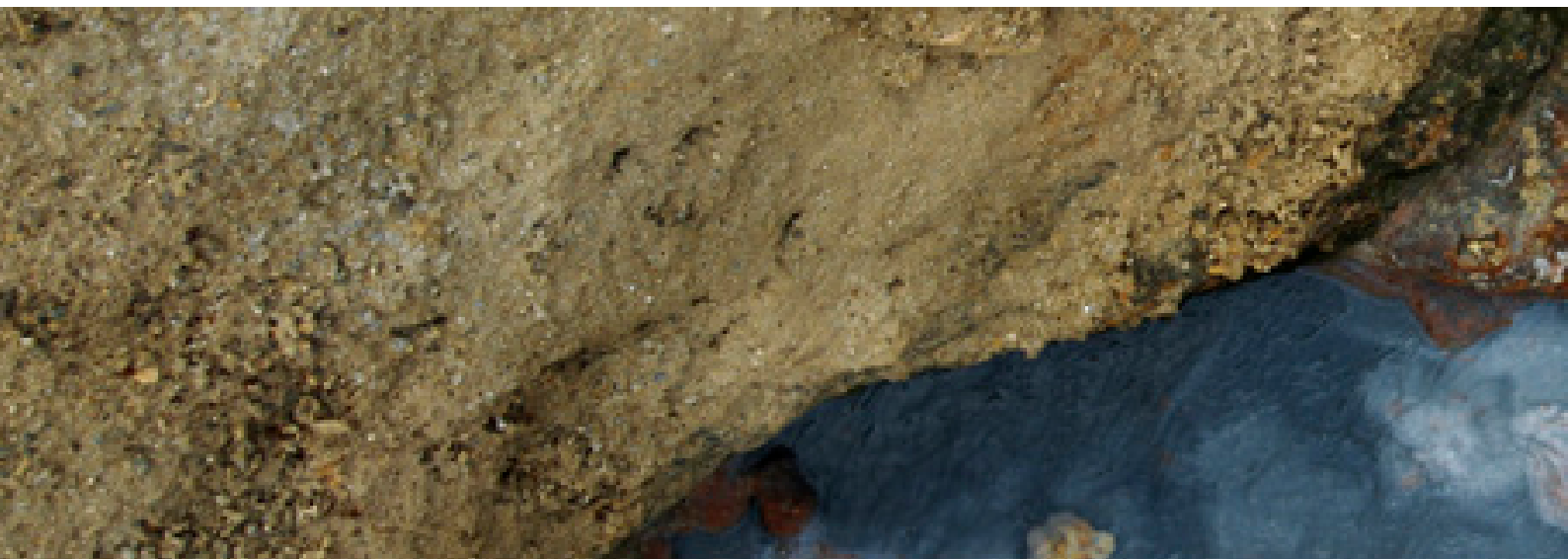
## Insights

The results of our last survey emphasized that directors thought ethical behaviour was very important. They placed it first in a ranking of practices. It was followed by sound corporate governance, effective engagement, communication and reporting to shareholders and continual improvement of environmental performance. For this survey we changed the list and asked respondents to rank their top three, in order of importance. We removed ethical behaviour and sound corporate governance from the list, as we doubted that their inclusion produced a meaningful result - everyone chose them, but the policies which companies had did not support their perceived importance. So we asked a new question, which is what practices companies consider that they do well.

Occupational health and safety, risk management and effective engagement, communication and reporting to shareholders emerged as the three most important practices for respondents. Respondents from large companies generally thought their companies did well at encouraging socially responsible behaviour and setting clear accountabilities for unethical or socially responsible behaviour. Nevertheless 29 percent of the respondents from large companies did not assess their companies as doing well in these areas. The figure for encouraging socially responsible behaviour was higher for medium companies (39 percent) and small companies (51 percent). Over 70 percent of respondents from small and medium companies did not assess their companies as doing well at setting clear accountabilities for unethical or socially irresponsible behaviour. So one conclusion you can come to is that a lot of companies, particularly at the smaller end, struggle to implement ethical behaviour.

It is also interesting to reflect on respondents' views on these matters in comparison with what they say about reporting them to the investment community. Large company respondents, 43 percent of whom consider that their company reports well to the investment community on these matters, are also in the range of 40 to 43 percent when it comes to publishing measurable corporate responsibility and sustainability goals in their annual reports. In comparison, 30 percent of respondents from small companies thought that their company did well in reporting these matters to the investment community - but only 6 to 8 percent publish measurable corporate responsibility and sustainability goals in their annual reports.

Two other aspects of the overall situation are worth noting. The first is that a significant proportion of respondents thought that ethical standards of those that their company deals with had improved in the last 5 years. That proportion was higher for large companies. Only a small proportion thought that they had got worse. This result was surprising given the focus on ethical standards and should be considered more closely. The second is that in their contractual dealings 40 percent of respondents were prepared to agree to act in good faith. That percentage was higher for explorers (57 percent) and small companies (44 percent) than large companies and developers (both at 29 percent). We found that a surprising result also. It would be good to test how many respondents fully understand the legal implications of "good faith". If that understanding was greater at the large company level, are less of them agreeing to act in good faith because of their negotiating power or because they disagree with the idea?





# Considerations for Directors

Ethical behaviour is very important in maintaining integrity, honesty and trust - all of which are key underpinnings of sound corporate governance. But by its nature it is very difficult to measure. For companies whose workforce spans different countries and cultures it is even more problematic to ensure there is a common benchmark of what constitutes ethical behaviour.

Matters to consider include:

- Do you have a clear set of guiding principles such as a code of ethics, and is performance assessed through things like 360 degree feedback and performance reviews? How is this reflected in your company's remuneration system?
- Do you have a published code of conduct or statement of values - has it been reviewed recently?
- What KPI's do you measure and report to the market which are relevant to ethics?
- Do you have a process to deal with ethical complaints, whether from within the company or from customers and other external parties?
- Do those responsible for negotiating contracts in your company have a clear understanding of the difference between acting in good faith and acting reasonably?
- Do you have any training programmes that deal with these questions?



## Comment from Fiona Harris, Non-Executive Director

Fiona Harris has 19 years of non-executive director experience with roles on numerous major publically listed, private, government and not for profit boards throughout Australia and with operations across the globe. She is currently the Chairman of Toro Energy (since March 2015) and is a Non-Executive Director of Oil Search (since 2013) and Infigen Energy (since 2011), amongst others. A former national Director of the Australian Institute of Company Directors, Fiona is also an adviser to boards in relation to governance and performance matters. With significant experience in guiding the development of corporate governance for companies as they move from exploration through to production, or from small to large, Fiona shares her views on some of the key areas covered in this report.



In our previous survey, Fiona was also kind enough to discuss her views with us. So what is really interesting is to look at the some of the key topics that were discussed with Fiona then and where our discussion took us this time round.

The three key topics of this year's discussion, which are all ultimately linked, were: scenario analysis or stress testing, operating in an environment where general expectations should be "lower for longer" and access to funding.

## Scenario analysis

Nearly two years ago the examples and discussions with Fiona referenced spot iron ore prices of USD100 - 120 a tonne. The project sign-offs of the example used were based on what was seen as a very conservative, at the time, \$73 a tonne breakeven. Now nothing new is being said regarding the way the market as a whole was taken by surprise over the past year when iron ore dipped below \$50. The point to be made from a director and senior management's perspective is as Fiona says, "...to make sure you prepare scenarios for what at the time may feel like totally improbable outcomes." From a logical risk management perspective the next step is to have in place a range of action plans or steps as worst case assumptions start to become reality.

## "Lower for longer"

Corporates and their directors need to get used to it being lower for longer says Fiona. This was a general comment made with regard to commodity prices but flows directly on to the need to really manage down costs and optimise processes which has been the focus of many, if not all, mining Corporates for the past eighteen months. It also goes to the point at which Executives and Directors look to hedge FX or commodity prices. Fiona noted previously that generally commodity hedging was only looked at for the purpose of meeting debt covenants and was required by the banks. This year she noted that hedging could be used to lock in economics of specific transactions and M&A activity but that generally hedging is not widespread as the diversification of these risks is still considered to be done at the investor portfolio level.

That being said, it is good governance to ensure that core working capital and cash flows are protected. So without exposing the business to hedges that cannot be delivered into, boards and management should review whether the base cash flow for operations and liquidity requirements could or should be insured/hedged using simple derivatives.

## Access to funds

A natural flow on after discussing cash flow and liquidity requirements is the ability of projects or corporates to attract funds through capital or debt markets. The difficulty, especially for single project companies, was discussed with Fiona two years ago – the market has however taken this to a different level with commodity prices down over that same period. For example reductions in iron ore (\$130 to \$63) and oil (USD108 – 60) prices have had a massive impact of the viability of many projects.

Doing things differently and being agile certainly are key differentiators to survival if your business is operating at the margins. Two developments becoming more common would be:

- where the market's perception of a company's value is less than that of the directors and executive team, mutual scrip based mergers should be evaluated as a way to protect value – particularly if you are running short on cash
- being innovative and involving the supply chain is also an option such as was the case with Atlas Iron and the well-publicised negotiations between its contractors in order to achieve a profitable operating model for Atlas and protect the supply for major contracts. So in short, different commercial risk sharing options.

Finally we explored from a governance perspective how directors try to get comfortable with the level of reporting they receive. Fiona discussed the practicalities based on available time at a NED level to receive and digest management reporting and the need to implicitly cross-check internal data with external information, including market and analyst's commentary, as well as to consider other existing sources of assurance. Any decision to bring in independent experts would then be made taking into account the residual risks and the significance of the item.

It was interesting to note that the risk function for small resource companies still sits from her perspective / experience reporting into the company secretary or CFO role, with line of sight to the Chair of the relevant Board committee. This is a developing area from a governance perspective where risk is being seen more as a business enabler as opposed to a more old school approach of being only a downside risk management and compliance role. As the environment evolves and risk optimisation is seen as a key part of every business decision one might expect the input and role of risk managers to be elevated in line with that of heads of operations and CFO's. This is already the case in many large organisations, led by the financial services sector due to the requirements of the regulator.

“As the environment evolves and risk optimisation is seen as a key part of every business decision one might expect the input and role of risk managers to be elevated in line with that of heads of operations and CFOs.”



## Bribery and corruption

During our last survey, a number of countries were strengthening their laws combatting bribery and corruption. That trend has not diminished, and dealing with these matters is particularly problematic for companies with overseas operations.

We asked respondents how concerned they were about bribery and corruption in Australia and overseas and the controls they use to manage it.

## Findings

### Who is concerned about bribery and corruption?

Across all companies bribery and corruption was a matter of concern - 61 percent of respondents for their overseas operations and 24 percent for Australian operations – **Figures 21 and 22**.

Organisations with operations in Africa, services companies and oil & gas companies, were the groupings that considered this risk the most significant – 78 to 81 percent. By way of contrast, those with South American operations were concerned slightly less about bribery and corruption (62 percent).

### Controls over bribery and corruption

Across all companies, around 80 percent of respondents had a code of conduct or other policy document which clearly outlines acceptable and unacceptable behaviour regarding bribery and corruption – **Figure 23**.

Fewer companies had an internal audit or similar function (27 percent) or used local advisers to advise how to avoid bribery and corruption (20 percent). There was a noticeable increase in internal audit when companies reached the large size.

Service providers and companies with South American operations had a higher use of internal audit and local advisers. For example, 87 percent of companies with South American operations had an internal audit function; for companies with African operations this was 31 percent. Perhaps this contributed to respondents from companies with South American operations having a lower level of concern (at 62 percent) about bribery and corruption – **Figures 24 and 25**.

Figure 21: Concern about bribery and corruption for Australian operations

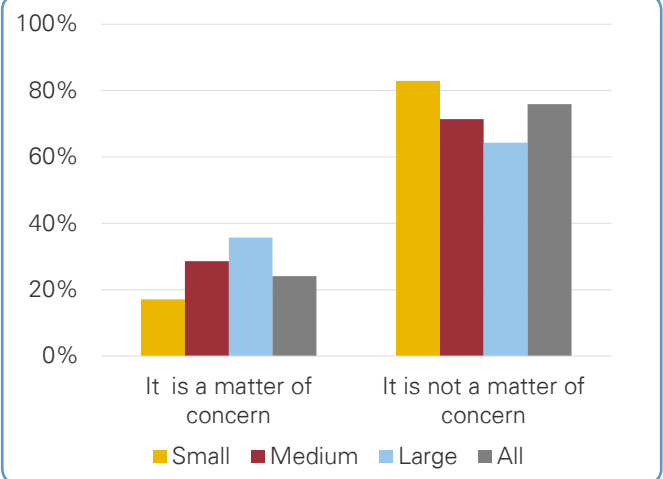


Figure 22: Concern about bribery and corruption for overseas operations

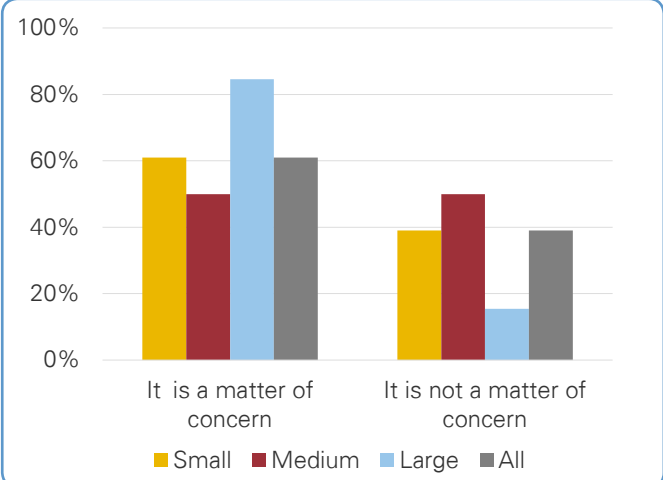




Figure 23: Bribery and corruption controls by company size

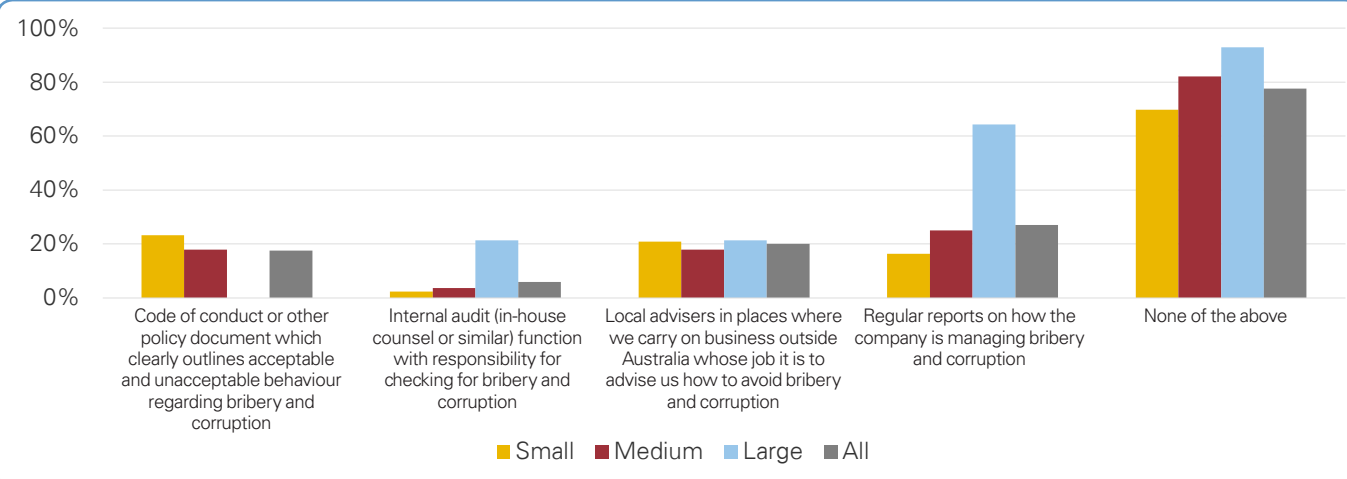


Figure 24: Bribery and corruption throughout the project lifecycle

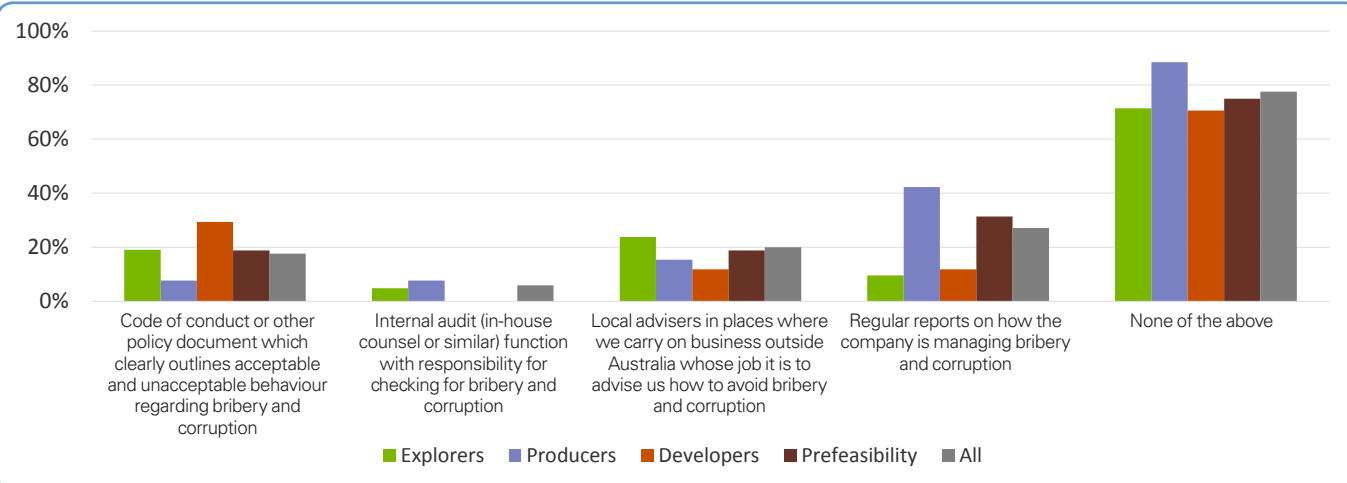
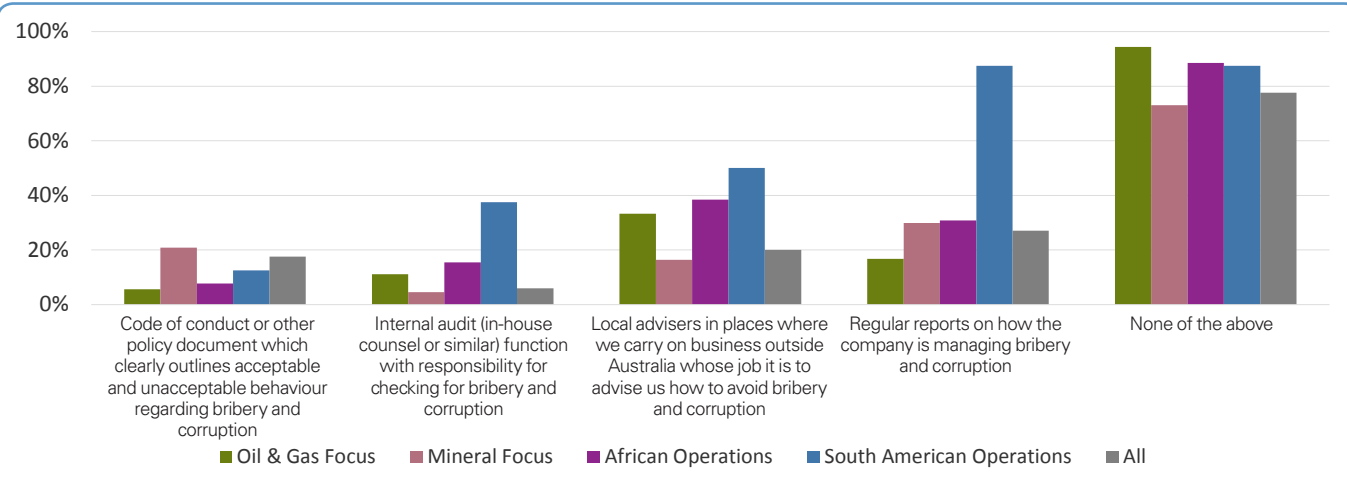


Figure 25: Bribery and corruption controls by area of focus



## Insights

Mining and oil and gas companies are continuing to have a significant overseas focus. Africa remains the continent in which most respondents had operations (26 companies). 8 had operations in South America, 8 in Europe, 7 in the United States of America, 6 in Indonesia and 23 in a broad range of countries including Cambodia, Tunisia, the Philippines, China and India.

As with the last survey, we found that small companies are less likely to have formal controls over bribery and corruption than large ones. But since the last survey there has been a significant increase in small companies having a code of conduct, with 70 percent or more having one. 17 percent of small companies had an internal audit function and 21 percent used local advisers. Those figures make an interesting comparison with developers. In this survey only 12 percent of developers had an internal audit function or used local advisers. The internal audit percentage for developers is much lower than in the last survey, when it stood at 41 percent. It seemed logical to us that companies would increase their controls given that additional money has to be spent in the development phase and there are prospective cash flows to meet internal audit costs.

However, the overall reduction in developers with an internal audit function which examines bribery and corruption issues comes as a surprise, and warrants further examination.



## Considerations for Directors

Bribery and corruption present particular difficulties for companies with overseas operations because of the need to comply with increasingly stringent international rules in places where the local culture does not necessarily see bribery and corruption as anything other than normal behaviour, and where it is not strongly discouraged by government at various levels. These difficulties are compounded for companies which have a listing or operations in a country like the United States or the United Kingdom which have strict rules against bribery and corruption for offshore operations (the US Foreign Corrupt Practices Act and the UK Bribery Act 2010).

Matters to consider include:

- Are your code of conduct and, if you have one, your bribery and corruption policy up to date and have they been reviewed in the countries where you operate?
- Do you understand what a facilitation payment is and how making a facilitation payment could give rise to a criminal offence? If your company made a facilitation payment in its overseas operations whose laws would apply, and is there an offence applicable to directors or officers of your company?
- How is compliance with international bribery laws managed in your company?
- If your company does not have an internal-audit function, are there processes the board can initiate to satisfy itself that no bribes are being paid?
- Is the prevention of fraud generally something which your company monitors, particularly at times of significant risk such as the negotiation of large contracts or the payment of project costs?
- How does your company demonstrate its attitude to bribery and corruption? Is there a clear message from the top that it is not acceptable?



# New developments on the horizon

From this survey, the focus of respondents is equally around volatility in commodity prices and currency exchange. There is a lesser focus or concern around regulations and compliance. It is worth highlighting some of the broader areas that are an increasingly discussed in the media, by regulators and as a result are a more prevalent topic of discussion by boards.

Given the increasing reliance on technology and digitisation of business, it is surprising that technology is not rated more highly as an area of risk. Social media and cyber security risk were added this year for the first time and this risk just made it into the “somewhat challenging” rating. Possibly this is because the level of understanding around exactly how much of a risk cyber security is continues to evolve.

Organisations may believe that unless they are operating autonomous fleets or have international offices that they will be unlikely targets. This is however far from the truth and organisations of all sizes and complexity are equally at risk. Often it will be the mid-tier rather than the global mining companies that will be targeted because they will be seen as a softer target with less prevention and detection controls in place.

Potential impacts are greater than just reputational risk and the time taken to resolve the issue. Impacts include significant physical and intellectual property losses as well as in many circumstances penalties for data privacy breaches and/or customer/contractual compensation for delays caused.

Understanding of cyber risk is increasing and we anticipate to see this risk trending upwards in future surveys particularly as investors, governments and regulators are increasingly challenging board members to actively demonstrate diligence in this area. Regulators expect personal information to be protected and systems to be resilient to both accidents and deliberate attacks.

Cyber crime does not respect geographical boundaries and, as early adopters of technology, Australian businesses are at risk. The ubiquitous nature of technology means that now, more than ever, a practical but robust, defence strategy needs to be implemented. It should be driven from the most senior levels of the organisation, ingrained as part of the organisational culture and be supported by the information and technology infrastructure.

These views are consistent with the messages communicated to us by WA Regional Commissioner for ASIC, Ms Jane Gouvernet.

## How can Directors be on top of this issue?

To gain assurance that cyber risk is being managed, Board members need to be able to answer the right questions:

- Does our organisation meet its obligation for information assurance?
- Is data secure in our organisation?
- Do we fully understand our current threats and vulnerabilities?
- Do any of our supply chain partners put us at risk?
- Are our competitors ahead of us? If so, does this give them an advantage?
- Who in our organisation is responsible for cyber security issues and can they and the management team answer the following questions?
- Do we understand where our sensitive data is located, who can access it and how it is controlled?



## How can the Directors become more proactive, focused and preventative?

Board level awareness of emerging cyber threats and direct involvement in determining the response is critical. Threat intelligence can help organisations become more proactive, focused and preventative.

- How do we move from reacting to anticipating cyber attacks?
- How do we make sense of the cyber threats we face?
- How do we demonstrate the return on investment of our cyber security measures?
- When was the cyber threat last examined by the Board?
- Is cyber part of the Board's strategy discussions?
- Does our management know when to act? Which tactical option to pursue? Has it been effective?

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