

The CPA saga demonstrates why Australia's corporate governance code needs replacing

Written by The Conversation



The CPA were a part of the committee who originally wrote the ASX Code. AAP Image/Alan Porritt

The ongoing saga involving [CPA's board of directors and CEO Alex Malley](#) highlights the need for a new corporate governance code in Australia. The CPA, while not a publicly listed company, [adheres to the ASX Code of Corporate Governance](#) - in fact the CPA assisted the Australian Stock Exchange (ASX) in writing its code.

It is essential that the ASX code is replaced by a new code written by an independent body, in conjunction with stronger legislation. This will help combat future corporate governance scandals.

While the ASX code only directly applies to commercial corporations listing on the exchange, its governance principles are used to benchmark best practice elsewhere. Community organisations, sports, schools, [universities](#), professional bodies and governments use or invoke the ASX code.

For example, non-listed organisations have used the ASX code to align executive remuneration with corporate peers. It has also been used to replace elected directors with non-executive independent directors - those with no direct links to either management or substantial shareholders.

How did we get here?

As a tool of industry self-regulation, the ASX code was written by, and for, corporate insiders. The ASX code was developed by the [Corporate Governance Council](#), a body reporting to ASX Limited, owners of the exchange. The council is not monitored by a government body, and its members are not elected.

[Members of the Corporate Governance Council](#) include the Business Council of Australia, and

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key professional groups such as the the CPA. This is highly problematic, not because industry groups are unimportant, but because other corporate stakeholders (i.e. employees) are excluded. The role of the CPA in particular is conflicted because it also has been given the role of [regulating the professional standards of accountants](#) who in turn audit companies.

In the wake of the collapse of the [Bank of Credit and Commerce International](#) in 1991, British accounting bodies the Financial Reporting Council and the London Stock Exchange established a Corporate Governance Committee chaired by [Sir Adrian Cadbury](#) to produce updated corporate governance guidelines.

Cadbury's committee reported in December 1992 that more independent directors should be appointed to company boards. This was seen as a way of making boards more transparent and more accountable to shareholders, while also giving CEOs less power.

Australia had a similar catalyst for corporate governance change when insurer HIH went bust in 2001. It was this A\$5 billion collapse that prompted a response from the ASX, after the government announced a [Royal Commission](#) in 2003.

The commission identified failures in governance related to [mismanagement](#), accounting issues and specific instances of breaches of directors duties. Royal Commissioner Justice Owen noted that:

All those who participate in the direction and management of public companies need to identify and examine what they regard as the basic moral underpinning of their system of values.

Spurred on by the HIH findings and mirroring the strategic timing of the earlier Cadbury Report in the UK, the ASX adopted its code in 2003. Both Cadbury and the ASX ignored long known problems with the single board structure - a solitary board of directors consisting of executives and various others. [Research shows](#) that this structure entrenches the power of executive directors, especially CEOs.

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As heads of the corporate hierarchies, [CEOs have very wide personal discretion](#), personal access to immense resources and control over information. Board elections in a single board system are often undemocratic, because the board itself typically sets rules on who can run for election.

The code's application has created adverse effects. An example is the failure of [Principle 8](#) in the code to "remunerate fairly and responsibly" to control the [rapid escalation in CEO compensation](#)

. For example, the vague wording of Principle 8 has translated into executives receiving [exorbitant pay packets](#)

Two ad-hoc legislative changes, the 2010 [two-strikes](#) rule that allows shareholders to vote on executive remuneration and proposed rules for [executive remuneration in the banking industry](#), are attempting to clean up the mess the ASX Code has created.

Moving towards a German model

Germany has been far [more successful in preventing corporate governance](#) scandals. This is partly due to the fact that their corporate governance code was developed by a commission created by the German federal government. The commission included employee elected and union nominated supervisory board members, management board members (executives) and community representatives.

This commission has been [more effective](#) because it operates in public and has focused on supporting the intent of the existing legislation. Research has indicated that a state commission is less likely to be hijacked by a single vested interest group. In addition, they also exert greater ability to make corporations accountable.

It is notable the German commission is overseen by the Minister of Justice and Consumer Affairs. This approach reflects the German government's continued commitment to the idea of social partnership. My research in Germany indicates this commitment is also widely shared in the community, inside German companies including their boardrooms and by key actors such as business associations and unions.

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The German system mandates the need for a two-tiered board structure opposed to our single board system. A two-tiered system includes a supervisory board made up of up to half employee elected and/or union nominated directors and shareholder elected members. This supervisory board appoints and oversees a separate management board.

This legal separation of executive and non-executive directors, coupled with broader representation on supervisory boards, constrains CEO power and pay. The two-tiered board structure prevents German managers from controlling the election of supervisory board members. Owner elected supervisory board members also have access to information and perspectives that are not voiced in Australian boardrooms.

Employees' [share of profit has been reduced](#) over the last decade in Australia and the US. However, German employee and union nominated directors on supervisory boards have prevented a similar reduction. As a result, income inequality is less of a problem in Germany.

Adopting a German style code is not the only change that must be made to rebuild our broken corporate governance system. Legislative changes such as [adopting two-tiered boards](#) , introducing employee elected/union representation on boards and re-emphasising director duties are just three of many vital changes that must be made.

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