EXECUTIVE SUMMARY

Introduction

Corporate responsibility is emerging as an issue of critical importance in Australia's business community. This inquiry has provided the committee with the opportunity to closely examine this increasingly important aspect of the corporate governance of Australian companies.

Corporate responsibility is usually described in terms of a company or organisation considering, managing and balancing the economic, social and environmental impacts of its activities. During the course of the inquiry the committee received a great deal of evidence of the way many Australian companies are employing responsible corporate approaches to manage risk and to create corporate value, in areas beyond a company's traditional core business. Some Australian companies are leading the push towards greater sustainability, and have been key contributors to global developments in the establishment of sound mechanisms to report on sustainability.

Of particular interest to the committee was evidence that many companies are integrating the consideration of broader community interests into their core business strategies, rather than treating these issues as an add-on or a side show. The committee heard that such an approach was key to the success of their corporate responsibility endeavours. Also crucial was the need to balance a long term view of company viability and profitability with a focus on short term returns. The committee noted the view that the diverse range of companies and organisations of different sizes and from different sectors meant that it was inappropriate to apply a 'one-size-fits-all' approach to corporate responsibility.

Despite evidence that Australian companies have shown a greater engagement with the corporate responsibility agenda over the past decade, the committee also heard that by international standards, Australia lags in implementing and reporting on corporate responsibility. A number of points of view were put to the committee as to whether it was necessary to adopt a regulatory approach in order to increase responsible corporate behaviour, or whether there were other ways to provide encouragement to Australian companies.

Duties of directors

The committee heard a number of arguments in relation to whether or not existing requirements in the *Corporations Act 2001* allowed company directors to consider broader community interests, and whether any change was required to legislation to either permit, or require, responsible corporate behaviour.

A number of interpretations of the current legislative framework regarding the duties of directors were provided to the committee. At one end of the scale was the view, made prominent in the case concerning James Hardie Industries, that a director would be failing in his or her duties if consideration was given to any factors other than maximising profit. At the other end of the scale, the 'enlightened self-interest' interpretation of directors' duties argues that directors may consider and act upon the legitimate interests of stakeholders other than shareholders, to the extent that these interests are relevant to the corporation.

This 'enlightened self-interest' interpretation is favoured by the committee. Evidence received suggests that those companies already undertaking responsible corporate behaviour are being driven by factors that are clearly in the interests of the company. Maintaining and improving company reputation was cited as an important factor by companies, many of whom recognise that when corporate reputation suffers there can be significant business costs. Evidence also strongly suggested that an 'enlightened self-interest approach' assists companies in their efforts to recruit and retain high quality staff, particularly in the current tight labour market.

Also reflecting an enlightened self-interest approach and driving corporate responsibility was the desire of companies to avoid regulation. Many companies recognise that by taking voluntary action to improve responsible corporate performance, corporations may forestall regulatory measures to control their conduct. It was also evident that for many companies, acting in a responsible corporate manner was in the interests of the company because such behaviour attracted investment from ethical investment funds, a sector of increasing importance in Australia. Mainstream institutional investors, such as superannuation funds, are also becoming a strong driver towards corporate responsibility, as they increasingly recognise the importance of how companies manage their non-financial risks to overall financial performance.

The committee looked at a number of options for legislative change, including suggestions that the Corporations Act should direct companies, and in particular directors, to take into account the interests of stakeholders other than shareholders. Also considered was the use of a permissive provision which would clarify that directors are entitled to make decisions which reflect the interests of stakeholders other than shareholders.

It was put strongly to the committee, however, that there was no need to change the existing legal framework, because it is currently sufficiently open to allow companies to pursue a strategy of enlightened self interest. Indeed, many were already doing so. The committee is of the view that the Corporations Act permits directors to have regard for the interests of stakeholders other than shareholders, and that amendment to the Corporations Act is not required.

The role of institutional investors

A good deal of evidence to the committee concerned the role of institutional investors, and the important influence they can have on corporate behaviour. Institutional investors such as superannuation funds are, by their nature, more likely to take a long term view of a company's financial performance. Despite the focus of institutional investors on financial performance, evidence suggests that they are increasingly considering non-financial factors in the recognition that these can present significant risks and opportunities in relation to a company's future financial performance. The committee noted evidence that a significant impediment to institutional investors engaging more with the non-financial performance of companies was the deficiency in non-financial information. The committee closely examined ways of improving the quality and availability of non-financial information (see below under 'Sustainability reporting').

The committee considered evidence on whether legislation governing superannuation funds, and in particular the 'sole purpose test' in the *Superannuation Industry Supervision Act 1993*, limited 'responsible investment'. The committee concluded that it did not, but agrees with suggestions that detailed guidelines on the sole purpose test should be issued to clarify for superannuation trustees their position in relation to allocating investments to ethical investment fund managers.

The committee noted the April 2006 release of the United Nations Principles for Responsible Investment, to which three Australian investment funds have become signatories. The committee supports the further adoption of these UN Principles by Australian institutional investors and fund managers, and in particular recommends that the recently established Future Fund should become a signatory.

Sustainability reporting

Sustainability reporting refers to the practice of corporations and other organisations measuring and publicly reporting on their economic, social, and environmental performance, and future prospects. Sustainability reporting emerged as a significant issue in the inquiry.

The committee heard arguments as to whether reporting should be voluntary or mandatory. Overall, the committee concluded that reporting should remain voluntary. In particular, the committee took note of evidence suggesting that mandatory reporting would lead to a 'tick-the-box' culture of compliance. This is an undesirable outcome and one that defeats the purpose behind the concept of corporate responsibility. The committee is of the view that it is important for companies to be strongly encouraged to engage voluntarily in sustainability reporting rather than being forced to do so.

The committee notes the benefits of independent assurance and verification of sustainability reports, but also notes that there are significant costs associated with such verification. Accordingly, the committee supports the continuation of voluntary assurance and verification of sustainability reports. Other principles that should apply to sustainability reporting were explored. The committee supports reporting that is cost-effective and flexible, and comparable.

Many participants expressed support for a voluntary standardised reporting framework as the preferred way of encouraging corporate responsibility among Australian companies. The most prominent and widely accepted of these reporting guidelines mentioned in the course of the inquiry was the Global Reporting Initiative, or GRI, an international reporting framework favoured by many submitters.

The committee is strongly supportive of the GRI, and commends those Australian companies which are active contributors to, and participants in, the GRI process. However on balance the committee believes that it is too early to recommend it as the voluntary Australian framework. Nevertheless, the committee notes the strong support expressed for the GRI, and recommends that the Australian Government should continue to monitor its uptake, and provide guidance to the business community on how to apply the GRI Framework.

The committee examined in detail the current requirements for reporting in Australia, including requirements under the Corporations Act, and under the Listing Rules of the Australian Stock Exchange (ASX). Particular attention was given to the reporting requirements of the ASX Corporate Governance Council, in its *Principles of Good Corporate Governance and Best Practice Recommendations* (the ASX Council Recommendations). These Recommendations are framed under 10 Principles of Good Corporate Governance, and are neither mandatory nor prescriptive. They give companies the flexibility of adopting or not adopting the principles, under an 'if not why not' reporting approach.

At the time of writing, a review of the ASX Council Recommendations is underway, including a request from the Minister for the Environment and Heritage, Senator the Hon Ian Campbell. The committee supports Senator Campbell's referral, and encourages the ASX Corporate Governance Council to fully consider all options for enhancing the ASX Council Recommendations to facilitate greater comparability of voluntary non-financial reporting. In particular, the committee supports initiatives which would improve the quality and quantity of non-financial information available to financial markets. The committee makes some specific recommendations regarding the inclusion of further guidance in the ASX Council Recommendations. In particular, the committee recommends that further guidance be provided for companies to inform investors of material non-financial performance, by disclosing their top five sustainability risks, and by providing information on the strategies to manage those risks.

The committee also recognises the potential of the relatively new Operating and Financial Review (OFR) provisions of the Corporations Act, and recommends that each company auditor monitor and review disclosures made under these provisions, and make recommendations to the company Board regarding the adequacy of the disclosures.

Encouraging corporate responsibility

The committee takes the view that although it is not appropriate to mandate the consideration of stakeholder interests into directors' duties, or to mandate sustainability reporting, there is a need to seriously consider options to encourage greater uptake and disclosure of corporate responsibility activities.

A number of initiatives by business and industry to encourage corporate responsibility were brought to the attention of the committee. The mining and finance sectors provided encouraging examples, and the committee is strongly supportive of such sector wide, industry-led projects.

Of particular interest is an example from overseas: the United Kingdom industry-led organisation Business in the Community, a network which works with business to develop practical and sustainable solutions to manage and embed responsible business practice. The committee supports the establishment of such a network in Australia, and recommends that the Australian Government provide seed-funding for the network.

Another overseas example of a business-led initiative which is recommended for use in Australia is the London Stock Exchange's Corporate Responsibility Exchange, an online tool which reduces reporting costs and streamlines the dissemination of policies and practices in the area of corporate responsibility.

The remuneration arrangements for company directors and executives, which typically focus on short-term objectives, were seen by many submitters as an area to influence corporate behaviour. The committee believes that including longer-term incentives in remuneration packages is an effective way to encourage companies to take account of legitimate stakeholder interests, which will ultimately be in the better interests of the company, its shareholders and company stakeholders.

The performance of companies in the not-for-profit sector was also a matter for consideration by the committee. The committee noted many innovative and mutually beneficial partnerships between not-for-profit organisation and corporations. There was a concern that some not-for-profit organisations, although performing worthy community services and often having limited financial and staffing resources, were not fully considering the environmental and social impact of their own activities. The committee recommends that the not-for-profit sector should endeavour to meet the same standards of those expected of the for-profit sector in considering the interests of stakeholders.

Many submitters argued that government has an important role to play in encouraging and facilitating corporate responsibility. The committee agrees. The Australian Government already has in place a number of initiatives, most notably the Prime Minister's Community Business Partnership. The Partnership works to foster partnerships, promote corporate giving and corporate social responsibility, and act as a 'think-tank' on philanthropic matters. The committee strongly supports the Partnership, and recommends continuation of the trend towards a broader sustainability framework.

The committee acknowledges that government could do more to encourage and facilitate corporate responsibility. One way is by providing leadership in best practice, primarily through its own agencies and activities. The committee commends those government agencies that undertake sustainability reporting, and would like to see the rate of reporting continue to rise in the future. The committee recommends that, in order to show greater leadership, and to encourage more reporting by government agencies, the Australian Government establishes voluntary sustainability reporting targets for government agencies.

Government is a large purchaser of goods and services, and the Australian Government has in place a green procurement policy. A recent ANAO report into implementation of this policy concluded that although compliance with policy has improved over time, there is more scope for integrating sustainable development into Australian Government operations. The committee acknowledges the efforts of those agencies engaging with green procurement policy, and believes that government agencies should demonstrate leadership by improving their performance in this area. The committee recommends that, in order to show greater leadership, the Australian Government establishes voluntary targets for government agency procurement in areas such as water, waste, energy, vehicles and equipment.

In the interests of transparency, the voluntary targets set for government agencies in terms of sustainability reporting and green procurement should be disclosed in annual reports, along with a report on progress against these targets. In other areas where government policies exist in relation to environmental performance by government agencies, the committee expects agencies to comply with their obligations.

The committee received a strong message that government had a key role to play in the education of company directors, investors, and other stakeholders. The committee supports activities already in place, such as the Prime Minister's Community Business Partnerships, and government funding for the Australian Research Institute in Education for Sustainability at Macquarie University. The committee concluded that the Australian Government could increase its involvement in this area, and believes that it should develop educational materials to promote the benefits of corporate responsibility, for the institutional investment sector, and for the not-for-profit sector. The committee also sees a role for government in promoting international initiatives in the area of corporate responsibility. In recognition of concerns that the benefits of sustainability reporting were difficult to assess and quantify, the committee has recommended that the Australian Government, in consultation with the business community, undertake research in this area.

Another role suggested for government was in the area of providing financial incentives to encourage corporate responsibility, or in removing barriers that work against corporate responsibility. The committee supports consideration by Government of options for providing regulatory relief to corporations which voluntarily undertake specified corporate responsibility activities. In recognition of the high start-up costs faced by companies establishing a reporting regime, the committee recommends that the Australian Government should examine the feasibility of introducing inflated write-off arrangements for the year-one costs of initiating sustainability reports, to assist companies commencing sustainability reporting for the first time.

In recommending an increased role for government in encouraging corporate responsibility, the committee does not support the creation of a dedicated ministerial office (as some suggested), but does support the improved harmonisation of delivery of government programs, through a whole-of-government approach.

Concluding remarks

Corporate responsibility in Australia is still in its developmental stages, and over the course of the inquiry, the committee has been encouraged by the evidence of increasing engagement by Australian companies and Australian government agencies with sustainable practices and sustainability reporting. There is still much progress to be made, however, and it is important that the Australian Government and the Australian Securities and Investments Commission where appropriate continue to monitor progress.

The committee strongly supports further successful engagement in the voluntary development and wide adoption of corporate responsibility. The committee has formed the view that mandatory approaches to regulating director's duties and to sustainability reporting are not appropriate. Consequent on the recommendations of this report, the committee expects increasing engagement by corporations in corporate responsibility activities. This would obviate any future moves towards a mandatory approach. The committee believes that the recommendations contained in this report will play an important part in progressing the future of corporate responsibility in Australia.

The following section lists the recommendations made in the report.