Parliamentary Joint Committee on Corporations and Financial Services

Corporate responsibility: Managing risk and creating value

June 2006

ISBN 0 642 716595

Printed by the Senate Printing Unit, Parliament House, Canberra.

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DUTIES OF THE COMMITTEE

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the Parliamentary Committee's duties as follows:

(a) to inquire into, and report to both Houses on:

  (i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

  (ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

TERMS OF REFERENCE

On 23 June 2005, the Parliamentary Joint Committee on Corporations and Financial Services resolved to inquire into Corporate Responsibility and Triple-Bottom-Line reporting, for incorporated entities in Australia, with particular reference to:

a) The extent to which organisational decision-makers have an existing regard for the interests of stakeholders other than shareholders, and the broader community.

b) The extent to which organisational decision-makers should have regard for the interests of stakeholders other than shareholders, and the broader community.

c) The extent to which the current legal framework governing directors' duties encourages or discourages them from having regard for the interests stakeholders other than shareholders, and the broader community.

d) Whether revisions to the legal framework, particularly to the Corporations Act, are required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders other than shareholders, and the broader community. In considering this matter, the Committee will also have regard to obligations that exist in laws other than the Corporations Act.

e) Any alternative mechanisms, including voluntary measures that may enhance consideration of stakeholder interests by incorporated entities and/or their directors.

f) The appropriateness of reporting requirements associated with these issues.

g) Whether regulatory, legislative or other policy approaches in other countries could be adopted or adapted for Australia.

In inquiring into these matters, the Committee will consider both for profit and not-for-profit incorporated entities under the Corporations Act.

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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.

RECOMMENDATIONS

Recommendation 1

4.78 The committee finds that the *Corporations Act 2001* permits directors to have regard for the interests of stakeholders other than shareholders, and recommends that amendment to the directors' duties provisions within the Corporations Act is not required.

Recommendation 2

5.44 The committee recommends that the Australian Prudential Regulation Authority issue detailed guidelines on the sole purpose test to clarify for superannuation trustees their position in relation to allocating investments to sustainable responsible investment fund managers.

Recommendation 3

5.55 The committee recommends that institutional investors in Australia seriously consider becoming signatories to the United Nations Principles for Responsible Investment.

Recommendation 4

5.57 The committee recommends that the Future Fund should become a signatory to the United Nations Principles for Responsible Investment.

Recommendation 5

6.46 The committee recommends that sustainability reporting in Australia should remain voluntary.

Recommendation 6

6.160 The committee recommends that the Australian Government, through the Joint Environment Protection and Heritage Council / Ministerial Council on Energy Policy Working Group process, seek to rationalise Australia's greenhouse and energy reporting requirements into a national framework.

Recommendation 7

6.161 The committee recommends that government and industry should liaise on developing a mechanism for setting sectoral benchmarks for greenhouse and energy performance.

Recommendation 8

7.22 The committee recommends that each company auditor on an annual basis:

- **review the extent to which companies are making non-financial disclosures in their Operating and Financial Reviews; and**
- **make recommendations to the company Board regarding the adequacy of the disclosures to meet the evolving needs of shareholders, and the wider capital**

market in order to assess and value material non financial performance, risk profile and risk management strategies.

Recommendation 9

7.55 The committee recommends that:

- **it is premature to adopt the Global Reporting Initiative Framework as the voluntary Australian sustainability reporting framework; and**
- **that the Australian Government continue to monitor the acceptance and uptake of the Global Reporting Initiative Framework, both nationally and internationally, with a view to its suitability as the, or a basis for a, voluntary Australian sustainability reporting framework.**

Recommendation 10

7.70 The committee recommends that the Australian Stock Exchange Corporate Governance Council (ASX Council) provide further guidance to Principle 7 of the ASX Council's *Principles of Good Corporate Governance and Best Practice Recommendations* to the effect that companies should inform investors of the material non-financial aspects of a company's risk profile by disclosing their top five sustainability risks (unless they demonstrate having fewer); and providing information on the strategies to manage such risks.

Recommendation 11

7.71 The committee recommends that the ASX Council undertake industry consultation to determine whether there are areas where companies, investors, and other stakeholders believe further guidance is necessary in relation to the non-financial disclosure requirements under the ASX Council's *Principles of Good Corporate Governance and Best Practice Recommendations.*

Recommendation 12

7.102 The committee recommends that the Australian Securities and Investments Commission revise the *Section 1013DA disclosure guidelines* to be relevant to mainstream fund managers rather than simply to the more limited pool of ethical investment funds.

Recommendation 13

8.19 The committee recommends that the Australian Government provide seed funding to establish an organisation, the Australian Corporate Responsibility Network, to be modelled on the United Kingdom initiative Business in the Community.

Recommendation 14

8.30 The committee recommends that investors, stakeholders and relevant business associations should encourage companies to include long term (beyond a three to five year timeframe) and corporate responsibility performance measures as part of the remuneration packages of company directors, executive officers and managers.

Recommendation 15

8.39 The committee recommends that industry associations and peak bodies actively promote corporate responsibility to their members.

Recommendation 16

8.46 The committee recommends that the Australian Stock Exchange, in consultation with companies, institutional investors and rating agencies, establish and operate a central web-based tool for the dissemination of sustainability information, based on the London Stock Exchange's Corporate Responsibility Exchange. The Australian Government should consider whether both facilitation and seed funding is required to establish such a service.

Recommendation 17

8.49 The committee recommends that the proposed Australian Corporate Responsibility Network publicise and promote best practice examples across the spectrum of corporate responsibility activities and across industry sectors.

Recommendation 18

8.57 The committee recommends that the corporate not-for-profit sector should endeavour to meet the same standards as the corporate for-profit sector in considering the interests of stakeholders.

Recommendation 19

8.74 The committee recommends that the Prime Minister's Community Business Partnership continue to move beyond its initial focus on philanthropy, towards a broader sustainability framework.

Recommendation 20

8.92 The committee recommends that, in order to show greater leadership and to encourage more agencies to disclose their sustainability performance, the Australian Government establish:

- **voluntary sustainability reporting targets for government agencies;**
- **voluntary targets for government agency procurement in areas such as water, waste, energy, vehicles, equipment and consumables; and**
- **a requirement for each government agency to disclose such targets and to detail progress towards achieving these in its annual report.**

Recommendation 21

8.97 The committee recommends that the Australian Government's various corporate responsibility programs be co-ordinated through a whole-of-government approach.

Recommendation 22

8.111 The committee recommends that the Australian Government, in consultation with the investment community, develop educational material:

• regarding the materiality of non-financial risks, for use by institutional investors and fund managers; and

• to promote the United Nations Principles for Responsible Investment to institutional investors and fund managers.

Recommendation 23

8.116 The committee recommends that the Australian Government, in consultation with relevant sections of the business community, undertake research into quantifying the benefits of corporate responsibility and sustainability reporting.

Recommendation 24

8.122 Although recommending that it is premature to adopt the Global Reporting Initiative Framework, the committee recommends that in addition to the continued monitoring of its uptake, the Australian Government provide guidance to the business community, including the small business community, on how to apply the Global Reporting Initiative Framework.

Recommendation 25

8.126 The committee recommends that the Australian Government develop educational material to promote the UN Global Compact and to encourage Australian companies to become signatories where it is appropriate for them.

Recommendation 26

8.129 To protect Australia's interests, the committee recommends that where appropriate, the Australian Government facilitate and coordinate the participation of Australian corporations in international corporate responsibility initiatives.

Recommendation 27

8.131 The committee recommends that the Australian Government, in collaboration with relevant not-for-profit organisations, develop educational materials for not-for-profit organisations to promote the benefits of corporate responsibility within their own organisations.

Recommendation 28

8.146 The committee recommends that as a way of facilitating greater uptake of sustainability reporting, 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 that commence sustainability reporting for the first time.

Recommendation 29

8.151 The committee recommends that the Australian Government consider options for providing regulatory relief to corporations which voluntarily undertake specified corporate responsibility activities.

ABBREVIATIONS

ABCN	Australian Business and Community Network
ACOSS	Australian Council of Social Service
ACSI	Australian Council of Superannuation Investors
AICD	Australian Institute of Company Directors
ANAO	Australian National Audit Office
ANAO report	Australian National Audit Office, *Cross Portfolio Audit of Green Office Procurement*, December 2005
APRA	Australian Prudential Regulation Authority
ARIES	Australian Research Institute in Education for Sustainability
ASIC	Australian Securities and Investments Commission
ASX	Australian Stock Exchange
ASX Council Recommendations	Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003
AuSSI	Australian SAM Sustainability Index
BCA	Business Council of Australia
BITC	Business in the Community
BTGAS	BT Governance Advisory Service
CAMAC	Corporations and Markets Advisory Committee
CAER	Centre for Australian Ethical Research
CAER report	Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006
CEO	Chief Executive Officer
CFO	Chief Financial Officer

CGT	Capital Gains Tax
Corporations Act	*Corporations Act 2001*
CR	Corporate responsibility
CRI	Corporate Responsibility Index
CRT	Caux Round Table
CSA	Chartered Secretaries Australia
CSIRO	Commonwealth Scientific and Industrial Research Organisation
CSR	Corporate social responsibility
CUFA	Credit Union Foundation Australia
DEH	Department of the Environment and Heritage
DEH guide	Department of the Environment and Heritage, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators*, June 2003
Directive	EU Accounts Modernisation Directive
EIA	Ethical Investment Association
EMS	Environmental Management Systems
FaCSIA	Department of Families, Communities and Indigenous Affairs
Finsia	Financial Services Institute of Australasia
G3	Third revision of the Global Reporting Initiative Sustainability Reporting Guidelines
G100	Group of 100
G100 guide	Group of 100*, Guide to Review of Operations and Financial Condition*, 2003
GRI	Global Reporting Initiative
GRI Framework	The Framework consisting of Global Reporting Initiative's Sustainability Reporting Guidelines, Sector Supplements, guidance documents and technical protocols

GRI Guidelines	Global Reporting Initiative Sustainability Reporting Guidelines
IAG	Insurance Australia Group
JSE	Johannesburg Securities Exchange
MCA	Minerals Council of Australia
MD&A	Management discussion and analysis
MNE	Multinational enterprise
NGO	Non-governmental organisations
NRE	Nouvelles Régulations Économiques
OECD Guidelines	OECD Declaration on International Investment and Multinational Enterprises
OFR	Operating and Financial Review
Partnership	Prime Minister's Community Business Partnership
SAM	Sustainable Asset Management Australia
SME	Small to medium enterprise
SRI	Sustainable Responsible Investment
UN Principles	United Nations Principles for Responsible Investment
UNEP FI	United Nations Environment Programme Finance Initiative

CHAPTER 1

INTRODUCTION

Background

1.1 On 23 June 2005 the committee resolved to conduct an inquiry into corporate responsibility and triple-bottom-line reporting, for incorporated entities in Australia, with the following terms of reference:

a) The extent to which organisational decision-makers have an existing regard for the interests of stakeholders other than shareholders, and the broader community.

b) The extent to which organisational decision-makers should have regard for the interests of stakeholders other than shareholders, and the broader community.

c) The extent to which the current legal framework governing directors' duties encourages or discourages them from having regard for the interests stakeholders other than shareholders, and the broader community.

d) Whether revisions to the legal framework, particularly to the Corporations Act, are required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders other than shareholders, and the broader community. In considering this matter, the Committee will also have regard to obligations that exist in laws other than the Corporations Act.

e) Any alternative mechanisms, including voluntary measures that may enhance consideration of stakeholder interests by incorporated entities and/or their directors.

f) The appropriateness of reporting requirements associated with these issues.

g) Whether regulatory, legislative or other policy approaches in other countries could be adopted or adapted for Australia.

1.2 In inquiring into these matters, the committee was tasked with considering both profit and not-for-profit incorporated entities under the Corporations Act.

Conduct of the inquiry

1.3 The inquiry was advertised in *The Australian* newspaper and on the Internet. Written submissions were invited from interested parties. The committee contacted a wide range of corporations, peak bodies, industry groups, non-government organisations, and academics, inviting them to participate in the inquiry. Details of the inquiry were placed on the committee’s website.

1.4 The inquiry generated considerable interest. The committee received over 140 submissions from various individuals and organisations, the most number of submissions to an inquiry of the committee in the last decade. Submitters are listed at Appendix 1.

1.5 The committee held nine public hearings: in Sydney on 23 November 2005, 9 and 10 March 2006: in Perth on 20 February 2006: in Melbourne on 23 and 24 February and on 5 April 2006: and in Canberra on 27 and 29 March 2006. A list of witnesses who appeared at the hearings is at Appendix 2, and copies of the Hansard transcripts are available through the Internet at http://www.aph.gov.au/hansard

Inquiry by the Corporations and Markets Advisory Committee

1.6 In March 2005, the Parliamentary Secretary to the Treasurer, the Hon Chris Pearce MP asked the Corporations and Markets Advisory Committee (CAMAC), a body which advises the government on corporations and financial markets matters, to investigate corporate social responsibility. The parliamentary secretary in particular sought advice on whether there should be any change to the directors' duties provisions of the Corporations Act, and whether the Corporations Act should require certain types of companies to report on the social and environmental impact of their activities.

1.7 The scope of the CAMAC inquiry is comprehensive, and there are many issues common to both the CAMAC inquiry and the inquiry of the Joint Parliamentary Committee. In November 2005, CAMAC produced a valuable discussion paper, intended to provide information, draw out issues, and stimulate discussion. The Joint Parliamentary Committee has found this discussion paper very useful, and draws on its content in parts of this report.

Structure of the report

1.8 The inquiry report is presented in eight chapters. Chapter 2 provides a background to the debate on corporate responsibility, giving definitions, and outlining the historical context of corporate responsibility, the role of corporations in society, and the current state of play in Australia.

1.9 Chapter 3 discusses the drivers and principles of corporate responsibility, and chapter 4 addresses duties of directors under the *Corporations Act 2001*. Chapter 5 discusses the role of institutional investors in the corporate responsibility debate. Chapters 6 and 7 discuss sustainability reporting, and chapter 8 looks at ways to encourage corporate responsibility in Australia.

Acknowledgements

1.10 The committee thanks those organisations and individuals who made submissions and gave evidence at public hearings. The committee also thanks Ms Susan Dudley and Mr Jerome Davidson from the Parliamentary Library for their assistance in drafting parts of chapter 2.

CHAPTER 2

BACKGROUND

2.1 Corporate responsibility is emerging as an issue of critical importance for Australia's mainstream business community. Until relatively recently it was a fringe notion, largely the domain of academic discourse, and which resulted in sporadic corporate reporting on environmental and social impacts. Over the past decade, however, it has developed into a practical mechanism for companies to assess and manage their non-financial risks and maximise their long-term financial value. It is also a bourgeoning driver of modern financial markets. The rapid trends towards globalisation of financial and labour markets, and several disastrous, large-scale corporate collapses have brought the issue to a new level of prominence.

2.2 This chapter provides a background to the discussion on corporate responsibility. It looks at:

- definitions and concepts in relation to corporate responsibility;
- historical context;
- the role of corporations in society; and
- the current state of play in Australia.

Definitions and concepts

2.3 A number of submissions pointed to the fact that there is uncertainty about what corporate responsibility actually means. Mr Jeremy Cooper of the Australian Securities and Investments Commission (ASIC) outlined the definitional issues that arise in the area of corporate responsibility:

> [t]here are some very vexing terminology problems ... such as what a stakeholder is, what sustainability means, what triple bottom line reporting is and what we really mean by corporate social responsibility itself...[1]

2.4 This section of the chapter looks at definitions commonly put forward for the terms and concepts used in the debate on corporate responsibility.

Corporate responsibility and corporate social responsibility

2.5 The Australian Stock Exchange (ASX) points out that the terms 'corporate responsibility', 'corporate social responsibility', and 'sustainability' are used interchangeably.[2] Similarly, Mr Turner submitted that:

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1 Mr Jeremy Cooper, Deputy Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 29 March 2006, p. 11.

2 Australian Stock Exchange, *Submission 124*, p. 1.

> ...the terms 'corporate social responsibility', 'corporate social transparency', 'triple bottom line', 'corporate sustainability' and 'social and environmental responsibility' are all used to refer to the same concept.[3]

2.6 In the debate on corporate responsibility, the acronym for corporate social responsibility 'CSR' is frequently used. Another acronym used is 'CR', for corporate responsibility. A significant proportion of the evidence presented in this report uses these acronyms.

2.7 Corporate responsibility is usually described in terms of a company considering, managing and balancing the economic, social and environmental impacts of its activities. It is about companies assessing and managing risks, pursuing opportunities and creating corporate value, in areas beyond what would traditionally be regarded as a company's core business. It is also about companies taking an 'enlightened self-interest' approach to considering the legitimate interests of a company's stakeholders.

2.8 A submission from Monash University offered the following broad definition:

> CSR is acceptance by a corporation of responsibility for the social impact of its activities, including effects on the natural environment.[4]

2.9 The submission from the Treasury stated:

> Corporate social responsibility lacks a universally accepted definition. However, it can be described as a company's management of the economic, social and environmental impacts of its activities.[5]

2.10 The Business Council of Australia (BCA) submitted that corporate responsibility was more than merely corporate philanthropy.[6] The Treasury submission agreed with this view, pointing out that philanthropic initiatives could be financed by activities which are damaging to the communities in which business is conducted.[7]

2.11 The BCA noted the definitional problems around terms such as corporate responsibility, and commented that this lack of clarity can lead to considerable misunderstanding and controversy about what is meant by these terms. The BCA submitted that the essence of corporate responsibility was:

> Corporations operate within the community. For corporations to be sustainable and successful in the long term, they need to engage with the community and take account of community attitudes. Successful companies

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3 Mr Richard Turner, *Submission 5*, p. 5.

4 The Hon Dr Ken Coghill, Dr Leeora Black, Mr Dough Holmes, *Submission 71*, p. 4.

5 Department of the Treasury, *Submission 134*, p. 1.

6 Business Council of Australia, *Submission 108*, p. 6.

7 Department of the Treasury, *Submission 134*, p. 1.

> therefore factor into their forward strategies activities that manage the challenges and risks to the community and capture the opportunities that community engagement can bring. To be valid, these activities must deliver benefits both to the community and the shareholders of the corporation.[8]

2.12 Some submissions expressed concern over the use of the word 'responsibility'. For example, Habitat for Humanity Australia suggested that the use of the word 'responsibility' has connotations with corporate guilt, which it suggests has led to some difficulties in increasing corporate involvement in social activities and engagement.[9] The BCA also took issue with the word 'responsibility', arguing that it implied an obligation that had to be enforced:

> ...the use of the word 'responsibility', suggests that companies will not engage in CSR unless they are forced to. ... The risk in trying to develop a precise definition to CSR, particularly a narrow definition of CSR or what is meant by 'responsibility', is that the definition may inhibit companies from continuing to pursue innovative and creative activities that suit their own unique circumstances.[10]

2.13 ECOS Corporation echoed this view:

> Corporate Social Responsibility immediately implies obligation to do things that are against what business wants to do.[11]

2.14 Despite its shortcomings, the term 'corporate responsibility' will be used throughout this report. At times 'corporate responsibility' is used interchangeably with 'sustainability' and 'non-financial risk management'.

2.15 Recognising that corporate responsibility is a multi-faceted concept the committee makes no attempt to reach a conclusive definition. Because of the sheer diversity of modern corporations – in terms of size, sectors, stakeholders, structures and strategies – the concept of corporate responsibility can have a different meaning to different people and different organisations. However, there is a range of common elements. Chapters 3 and 6 also discuss a number of broad principles in relation to corporate responsibility.

Stakeholders

2.16 Stakeholders are the groups and individuals that are impacted on by corporate activity, and that themselves can impact on corporate activity. Stakeholders include company shareholders, but also include some non-shareholder interest groups. Stakeholders commonly identified include employees, the community, and the

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8 Business Council of Australia, *Submission 108*, p. 3.

9 Habitat for Humanity Australia, *Submission 125*, p. 1.

10 Business Council of Australia, *Submission 108*, p. 10

11 ECOS Corporation, *Submission 51*, p. 2. *Submission* 82 from Beerworth and Partners agreed with this view (p. 2).

environment. A submission from the Key Centre for Ethics, Law, Justice & Governance at Griffith University indicated that there were at least two approaches to defining 'stakeholder':

> The term 'stakeholder' covers a wide array of interest holders depending on the definition used. It is important to recognise that the stakeholder definition used impacts on what is required of corporations to meet CSR demands. Early stakeholder theory focused on the managerial model of an entity and, as a result, narrowly defined 'stakeholder' as a group that impacts on the success of the organisation in terms of production outcomes and transactions. The broader definition of the stakeholder view of the firm includes those who may affect or be affected by the organisation – employees, customers, local community, management, owners and suppliers and so on.[12]

2.17 The BCA pointed out that different companies and different sectors had different stakeholders to consider:

> While some stakeholders, such as employees, will be common to all corporations, many others vary significantly. A mining company for example is likely to place a higher priority on environmental issues than an accounting firm.[13]

2.18 Evidence to the committee indicated that corporations often face situations where stakeholders have conflicting interests.

> It is important to be aware of such [conflicting interests] and resist the temptation to place all interest holders under the same banner without recognition of the different agendas each stakeholder or stakeholder group brings to the debate. Recognition of the competing interests serves to highlight the balancing task corporations have, regardless of the types of reform implemented when it comes to balancing financial interests of the company and its shareholders, and the interests of other stakeholders.[14]

Corporate governance

2.19 The terms corporate responsibility and corporate governance are sometimes confused with each other. Corporate governance refers to broader issues of company management practices. It concerns the conduct of the board of directors and the relationships between the board, management and shareholders. At the core of corporate governance is the transparency of major corporate decisions, and accountability to shareholders.[15]

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12 Key Centre for Ethics, Law, Justice & Governance at Griffith University, *Submission 80*, p. 3.

13 Business Council of Australia, *Submission 108*, p. 8.

14 Key Centre for Ethics, Law, Justice & Governance at Griffith University, *Submission 80*, p. 3.

15 Investment and Financial Services Association Ltd, *Blue Book: Corporate Governance: A guide for fund managers and corporations*, October 2004, p. 9.

2.20 Corporate responsibility is only one aspect of an organisation's governance and risk management processes.[16]

Sustainable responsible investment

2.21 Sustainable Responsible Investment, or Socially Responsible Investment, is a term that was used in evidence to the committee. It is an approach to investment by institutional funds or individuals which places value on investments that minimise or do not have negative impacts on society and the environment. The Ethical Investment Association provides the following definition:

> Sustainable Responsible Investment (SRI) is the integration of personal values with investment decisions. It is an approach to investing that considers both the profit potential and the investment's impact on society and the environment.
>
> Sustainable Responsible Investment may avoid industries such as gaming, tobacco, armaments or uranium mining and companies with little regard for the environment, governance, and labour and human rights. On the other hand, SRI may also actively seek out profitable 'industries of the future' that are positive for society and the environment such as renewable energy, biotechnology, water management, waste management and health care.[17]

Sustainable development

2.22 Some submitters to the inquiry referred to the concept of sustainable development. This concept was defined in 1987 by the World Commission on Environment and Development chaired by the Prime Minister of Norway, Mrs Gro Harlem Bruntland, which published a report *Our Common Future* (the Bruntland Report).[18] The report provided a definition of sustainable development as development:

> that meets the needs of the present without compromising the ability of future generations to meet their own needs.[19]

Sustainability reporting

2.23 Sustainability reporting refers to reporting mechanisms used by organisations to disclose information on social, environmental, and economic performance. It facilitates reporting on achievements in sustainable development, and allows a degree of transparency to shareholders and other stakeholders of organisational performance and behaviour.

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16 KPMG, *Submission 53*, p. 2.

17 Website of the Ethical Investment Association, http://www.eia.org.au/, accessed 2 May 2006.

18 Website of the National Institute of Sustainability at Swinbourne University of Technology, Melbourne, at http://www.swinburne.edu.au/ncs/sustainability.htm, accessed 2 May 2006.

19 World Commission on Environment and Development, *Our Common Future*, Oxford University Press, Oxford, 1987, p. 43.

2.24 A recent report on sustainability reporting in Australia released by the Minister for the Environment and Heritage, Senator the Hon Ian Campbell described sustainability reporting as follows:

> Sustainability or non-financial reporting involves companies assessing their performance against environmental, social and economic criteria, how these results relate to the success of the business, and how potential impacts, opportunities and risks are addressed.[20]

2.25 The term 'triple bottom line reporting' is also used, referring to the three areas of performance: economic, environmental, and social. Chapter 6 of this report goes into some detail on sustainability reporting, the various reporting frameworks in existence, and the current status of sustainability reporting in Australia.

Historical context

2.26 The origins of the concept of corporate responsibility can be tracked back as far as the first half of the twentieth century. PricewaterhouseCoopers recognised in its submission that '[t]he term 'corporate responsibility' has been extensively discussed for over 100 years in the 'business in society' literature.'[21] For example in the 1930s a famous public debate in the United States between Professors Berle and Dodd considered the relative merits of either side of the argument. The debate continued to develop throughout the middle of the twentieth century as the size and influence of corporations grew and the dominance of multinational corporation became apparent.

2.27 The first examples of what has become triple bottom line or sustainability reporting occurred during the 1970s. These reports, although groundbreaking in nature, were typically adjuncts to annual reports, focussed on single issues, and provided little useful information about the overall performance of a company.

2.28 The next phase of corporate responsibility reports occurred in the late 1980s and early 1990s. Organisations such as The Body Shop, Shell Canada and Ben and Jerry's released the first combined social/environmental reports. These reports were an important landmark, demonstrating the level of commitment of these corporations to report publicly on their non-financial performance. Since this time a strong trend has emerged towards integrated social-environmental-economic reports (also known as triple bottom line reports or sustainability reports). Sustainability reporting is discussed further in chapters 6 and 7.

2.29 As a global issue, corporate responsibility has grown significantly over the past decade, particularly since the turn of the century. In its discussion paper on

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20 Media release of the Minister for the Environment and Heritage, Senator the Hon Ian Campbell, 24 March 2006, 'The State of Sustainability Reporting in Australia 2005', at http://www.deh.gov.au/minister/env/2006/mr24mar06.html , accessed 3 May 2006.

21 PricewaterhouseCoopers, *Submission 110*, p. 11.

corporate social responsibility, the Corporations and Markets Advisory Committee quoted recent research which shows:

> Whereas 54% of executives in one global survey in 2000 said that this notion was 'central' or 'important' to their corporate decision-making, that figure had grown by 2005 to 88% of executives surveyed. Likewise, whereas 34% of professional investors in that same global survey in 2000 said that corporate social responsibility was 'central' or 'important' to their investment decisions, that figure had risen by 2005 to 81%. Also, it has been suggested that perceptions of corporate social responsibility being more in the nature of corporate public relations or marketing rhetoric than substance may be diminishing.[22]

2.30 This quote demonstrates the significant global rise of corporate responsibility as a factor in corporate decision-making and investment practices. Importantly, there also appears to be a global trend towards 'doing' rather than mere rhetoric. In the view of the committee this is an encouraging trend that with appropriate government support will continue.

The role of corporations in society

2.31 The role of corporations in society was a matter for discussion during the inquiry. Is their function solely to make a profit, or do corporations have a wider responsibility to the society in which they operate and which allows them to exist? This section of the chapter looks at some of the background to this question.

2.32 Entities that structure collective commercial or community activity have long existed. Legal frameworks to regulate these entities have developed over centuries in response to increases in commercial activity, particularly since the rise of capitalism and the industrial revolution and the rise of large-scale organised interest groups. In particular, legal structures have evolved that place limits on the liability of investors, in order to attract investment. This principle of limited liability is discussed further below.

2.33 Australian corporate law owes much to the *Companies Act 1862* (UK) and its predecessor, the *Joint Stock Companies Act 1856* (UK), which allowed incorporation as of right (and with limited liability) through a simple registration process.[23] Schemes providing for the national regulation of companies in Australia have encountered a number of problems relating to the constitutional power of the Commonwealth Parliament but those now appear to have been finally settled with the referral by the States to the Commonwealth, in 2001, of the power necessary for such regulation.

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22 Corporations and Markets Advisory Committee, *Corporate Social Responsibility Discussion Paper*, November 2005, p. 1.

23 Mr Jerome Davidson and Ms Susan Dudley, *Introduction to the Corporations Act*, in Encyclopeadia of forms and precedents, Lexisnexis, 2005, p. 7.

2.34 Corporations have flourished in Australia and played a major role in the development of its economy. The stimulation of investment brought about by the corporate structure and the associated limited liability have enabled the effective exploitation of Australia's vast natural resources, as well as fostering the development of its general industries. As noted in Treasury's submission:

> Corporations, large and small, multinational and local, play a fundamental, multi-dimensional and evolving role in promoting economic growth and improving the living standards of all Australians.[24]

2.35 Many submissions to the inquiry highlighted the benefits of corporations. Australian companies generate considerable tax revenue for the Commonwealth, the states and territories. The Business Council of Australia submitted that as a percentage of GDP, the tax paid by Australian companies is well above the OECD average.[25] By contrast, the recent Warburton-Hendry review of Australia's tax regime found that Australia's 30 per cent corporate tax rate is slightly above the unweighted OECD average of 28.5 per cent, and below the weighted average of 36.5 per cent.[26] Beerworth & Partners summarised the economic benefits of companies by pointing out that the modern day corporation:

- allows passive capital to be used actively;
- limits the liability of the subscribers of that passive capital;
- provides leverage for successful corporate managers enormously beyond their own resources; and
- is the most powerful engine ever devised for capital formation – the aggregation of vast amounts of private capital for enterprise.[27]

2.36 The BCA pointed out the benefits of corporations to society, including the creation of employment:

> It is important to note that ... the greatest social contribution made by corporations is through the goods and services they provide, the wealth they create and the employment they generate.[28]

2.37 Mining and production company Alcoa provided an example of the way corporations can have a positive impact on local economies and employment:

> Our investment has provided essential infrastructure and supported the growth of regional communities. We are one of Australia's leading regional

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24 Department of the Treasury, *Submission 134*, p. 1.

25 Business Council of Australia, *Submission 108*, p. 3.

26 R.F.E. Warburton, *Discussion of International Comparison of Australia's taxes*, April 2006, p. xxii.

27 Beerworth & Partners, *Submission 82*, p. 3.

28 Business Council of Australia, *Submission 108*, p. 8.

> employers, and we provide more than 7,500 jobs, mainly in regional Victoria and Western Australia.[29]

2.38 Treasury quoted the Hon Justice Michael Kirby to demonstrate the economic and social benefits of corporations:

> the idea of an independent corporation, governed by directors and accountable to shareholders, was a brilliant one. It permitted people to raise capital from the public, to invest it without, in most cases, a danger of personal risk and to engage in entrepreneurial activity which, otherwise, would probably not occur.[30]

2.39 The role of corporations in society has changed remarkably over time. From relatively humble business ventures to the gigantic multinational enterprises of today, corporations continue to have a growing influence globally. In 2000, the Institute for Policy Studies released a study that showed that of the world's 100 largest economic entities, 51 are corporations and 49 are countries.[31]

2.40 Corporations are also taking a greater role in the provision of what are often referred to as 'public' or 'essential services'. With the rise of the privatisation of government businesses and government owned assets, corporations are taking on more and more societal roles that were traditionally seen as the domain of governments. For example commercial and not-for-profit corporations are now actively involved in the management and operation of 'public services' such as hospitals, child care, education, employment services, water and electricity supply, telecommunications, banking, defence, etc.

Types of corporations

2.41 Companies operate in many facets of everyday life. A company may be run for profit, such as BHP Billiton and the ANZ Bank, or they may be a not-for-profit company, such as the Smith Family and Mission Australia. Companies operate in both the private and the public sector spheres, being used by individuals, organisations, and governments alike as a vehicle for achieving their objectives. There are of course other structures recognised by law for achieving business and social ends such as partnerships, trusts and incorporated associations. For reasons discussed below, companies have however proved to be a very popular legal form for conducting business.

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29 Mr Kim Horne, Refinery Manager, Pinjarra, Alcoa World Alumina Australia, *Committee Hansard*, 20 February 2006, p. 13.

30 Department of the Treasury, *Submission 134*, p. 2.

31 Sarah Anderson and John Cavanagh, Top 200: The rise of rise of corporate global power, Institute for Policy Studies, 2000, http://www.ips-dc.org/downloads/Top_200.pdf, accessed 19 May 2006.

2.42 There are over 1.4 million companies in Australia.[32] Companies can be established in a number of ways. Most companies in Australia have been established following the procedures set out in the *Corporations Act 2001* and its predecessors.

2.43 Companies established under the Corporations Act must either be proprietary companies or public companies. The key difference between public and proprietary companies is that proprietary companies cannot have more than 50 shareholders (excluding shareholders who are employees) and they are not permitted to engage in certain fundraising activities. In contrast, there is no limitation on the amount of people who can be shareholders of public companies, and public companies are permitted to engage in certain fundraising activities such as issuing shares to the general public. One way that public companies can raise funds is by listing on the Australian Stock Exchange (ASX). Currently there are approximately 1,900 public companies listed on the ASX with a market capitalisation of $1.1 trillion.[33]

Key features of companies

2.44 Companies have two legal features which have made them a very popular vehicle for conducting business. These are the notion of the corporation being a separate legal entity and the fact that limited liability may attach to a company.

Separate legal entity

2.45 A company is regarded as a legal entity separate from the people who established it.[34] It also exists as an entity separate from company shareholders and the people who manage it.[35] A corporation has all the legal powers and capacities of an individual.[36] As a result it can contract in its own right, it can sue and be sued, hold property and do other things that an individual is able to do.

2.46 As a result of the notion of a separate legal entity, creditors of the company must look to the company rather than people involved with the company's operations (such as directors) when making a claim to recover money owed by the company.

2.47 The Corporations Act and the common law have developed a limited number of circumstances where the notion of the separate legal entity can be disregarded and legal responsibility for actions of the company can be placed on people who are associated with the company. This is known as 'piercing the corporate veil'. Circumstances where the corporate veil can be pierced include where the company has engaged in insolvent trading, where the reverse onus of proof mechanism is used, and where the company is used as a vehicle for fraud.

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32 Department of the Treasury, *Submission 134*, p. 2.

33 Department of the Treasury, *Submission 134*, p. 2.

34 Salomon v Salomon & Co Ltd [1897] AC 22.

35 Salomon v Salomon & Co Ltd [1897] AC 22.

36 *Corporations Act 2001*, s. 124.

Limited liability

2.48 A company may be a limited liability company. The effect of limited liability is that shareholders are not liable for the company's debts.[37]

2.49 Not all companies under the Corporations Act are limited liability companies. Proprietary companies can take two forms; proprietary companies limited by shares and unlimited proprietary companies with share capital. Public companies can take four forms; companies limited by shares, companies limited by guarantee, unlimited companies with share capital and no liability companies. Out of these six types of companies, limited liability applies to companies limited by shares and companies limited by guarantee.

2.50 For companies that are limited by shares, the liability of company shareholders is limited to the amount (if any) that they still owe the company for the purchase of their shares. If the shares are fully paid shares, shareholders will have no further liability. If the company is limited by guarantee, the liability of shareholders is limited to the amount of money owed under that guarantee.

2.51 A number of benefits of limited liability have been noted. In particular, it facilitates investment and otherwise encourages economic activity by separating investment and management functions and shielding investors from any corporate loss in excess of their equity capital. This protection for investors reduces the cost of raising capital.[38]

Decision making process and influences

2.52 Whilst the company's constitution will determine the split of decision making between the directors and the company shareholders, generally speaking the board of directors has the power to make decisions on all business matters other than those that have been expressly stated as being for shareholders to vote on at a general meeting. Directors have a series of legal responsibilities or duties to the company. These include the requirement that they act in good faith, with care and diligence, for the benefit of the company and for the purpose for which a power was conferred. They also must not secure an advantage to themselves or others.[39] Whilst directors do bear ultimate responsibility for decision making, many of the day to day decisions made for the corporation are made by company officers (such as Chief Executive Officers, Chief Financial Officers and Secretaries) who do not sit on the board of directors.

2.53 When making decisions for the company, directors and company officers may have to choose between a decision which produces short term benefits for the

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37 Phillip Lipton and Abe Hertzberg, *Understanding Company Law*, thirteenth edition, Lawbook Company, 2006.

38 Companies and Securities Advisory Committee, *Corporate Groups Final Report*, May 2000.

39 Australian Institute of Company Directors, *Submission 73*, p. 7

company or one that achieves long term results. Decision makers may often find themselves under pressure to secure short term benefits at the expense of achieving more long term objectives in order to meet their own personal performance measures as well as posting adequate financial results for the company. This 'short-termism' approach is discussed further in chapter 3.

The state of play in Australia

2.54 Over the past decade, Australian businesses, governments, communities and academia have generally shown greater engagement with the corporate responsibility agenda. For example, Philanthropy Australia stated in its submission:

> There is undoubted growth in corporate community activity in Australia, evidenced through Australian Bureau of Statistics data and more generally in the growth of voluntary corporate participation in initiatives such as the Australian Corporate Responsibility Index, the Prime Minister's Community Business Partnership Awards, and the Global Reporting [Initiative].[40]

2.55 Australia also has many companies that are leading the push towards greater sustainability. It is impossible to provide a comprehensive list of strong corporate performers in this area without the risk of omitting a committed company. However it is worthwhile noting a couple of the very strong performers.

2.56 Westpac Corporation was cited in many submissions as a leader in the adoption of corporate citizenship.[41] Rio Tinto and BHP Billiton were also cited as leaders in the field.[42] The mining and resources sector in general has been a strong performer, primarily as a result of their ongoing need for mining approvals. Australia's finance sector is also considered to be highly engaged.

2.57 Some Australian companies have been key contributors to developments in the area of global reporting mechanisms. Westpac and National Australia Bank have contributed to international initiatives such as the Global Reporting Initiative.

Sustainability reporting

2.58 KPMG reports that there has been a significant increase in the rate of sustainability reporting in Australia over recent years. Data indicates that the number of sustainability reports produced by the top 500 companies in Australia has increased as follows:

1995: 6 companies (1%)

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40 Philanthropy Australia, *Submission 23*, p. 3.

41 For example, see *Submission 2*, Dr Gianni Zappalà, p. 7.

42 Dr Gianni Zappalà, *Submission 2*, p. 7.

2000: 65 companies (13%)

2005: 119 companies (24%)[43]

2.59 Despite this progress, developments in sustainability reporting have been slow in comparison to other developed countries. According to KPMG, which has conducted several national and international surveys into sustainability reporting, '[i]n Australia the public reporting by organisations...is well below that of most developed countries...although it is increasing rapidly from this low base.'[44]

2.60 The following data indicates the percentage of sustainability reports produced in 2005 by the top 100 companies in certain developed countries, and shows Australia's poor showing internationally:

- Japan: 81%
- UK: 71%
- Average (16 countries): 41%
- Australia: 23%[45]

2.61 The committee notes several reasons for the higher rate of reporting in other countries including legislative requirements to disclose sustainability information and more active consumers and non-governmental organisations advocating for improvement. The committee notes that a low level of sustainability reporting does not necessarily correlate to low level of responsible corporate activities. However, the level of reporting activity is seen as an important indicator of the level of interest and commitment of Australian companies.

2.62 Progress in Australia in the area of sustainability reporting is considered in more detail in chapter 6.

Prime Minister's Community Business Partnership

2.63 A significant initiative taken by the Australian Government in recent years is the Prime Minister's Community Business Partnership (the Partnership), and related initiatives. The Partnership was established in 1999. It is a group of prominent Australians from the community and business sectors who work to foster community business partnerships, act as a 'think-tank' on philanthropic matters and promote corporate giving and corporate social responsibility.[46] The Prime Minister chairs the group. The Partnership's programs and initiatives, which focus on community

43 KPMG, *Submission 53*, p. 3.

44 KPMG, *Submission 53*, covering letter p. 1.

45 KPMG, *Submission* 53, p. 3.

46 Department of Family, Community Services and Indigenous Affairs, *Submission 133*, p. 2.

business collaboration and corporate social responsibility are discussed in more detail in chapter 8.

ASX Corporate Governance Principles

2.64 Another recent development in Australia has been an initiative by the Australian Stock Exchange (ASX), focussing on the corporate governance practices of listed companies. In response to a number of high-profile corporate collapses which occurred in Australia and overseas throughout 2001 and 2002, the ASX Corporate Governance Council released its *Principles of Good Corporate Governance and Best Practice Recommendations* (the ASX Council Recommendations).

2.65 Although the ASX Council Recommendations are designed to encourage improved corporate governance practices, three of the ten principles relate to the disclosure of sustainability information. These principles are: to promote ethical and responsible decision-making; to recognise and manage risk; and to recognise the legitimate interests of stakeholders.[47] The ASX Council Recommendations are explored in detail in chapter 7.

Corporate philanthropy

2.66 Surveys have shown that philanthropic activities by Australian business have increased in recent years. A recent study, *Giving Australia: Research on Australian Philanthropy,* identified that business giving in 2003–04 more than doubled since 2000–01, with more than 525,000 businesses, or 67 per cent of all businesses, giving $3.3 billion in money, goods, services and time during 2003–04.[48] The report was coordinated by the Australian Council of Social Service and funded by the Prime Minister's Community Partnerships Program.

2.67 The report noted the advantages for business in engaging in corporate philanthropy:

> For business, giving to nonprofit organisations may result in profile or advertising and attract or retain customers (eg via sponsorship). Business may attract staff or improve staff retention rates or skills through employee volunteering or giving programs.[49]

Community consultation

2.68 An innovative development in Australia in recent years has been the setting up of consultative arrangements between corporations and representative community

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47 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003.

48 Department of Family, Community Services and Indigenous Affairs, *Submission 133*, p. 4.

49 *Giving Australia: Research on Philanthropy in Australia: Summary of Findings*, Commonwealth of Australia, October 2005, Executive Summary, p. x.

groups, to facilitate engagement with the community, and two-way communication. Westpac gave the example of its Community Consultative Councils, which it says play a critical role in focussing Westpac's corporate responsibility activities:

> Council members are drawn from community and government organisations in subject areas relevant to Westpac's social and environmental impacts. .....
>
> The Council supplements ad-hoc and project-based dialogue with external stakeholders and brings together the leaders of these organisations with the CEO and key executives. It provides Westpac with feedback on its policies and strategic direction.[50]

2.69 Energy retailer Origin Energy also gave evidence of its community consultation. Mr Tony Wood of Origin Energy told the committee how, after consultation with representative non-government organisations such as the Brotherhood of St Laurence, innovative practices were adopted to assist customers experiencing financial hardship to pay their bills.[51]

Sustainable responsible investment

2.70 According to the Ethical Investment Association (EIA), there has been a significant increase in Australian funds managed as sustainable investments, also known as Sustainable Responsible Investment (SRI). The EIA in its survey entitled *Sustainable Responsible Investment in Australia 2005* reported that during the 2005 financial year, SRI managed funds grew by around 70 percent (from $4.5 billion to $7.7 billion). In the five years between 2000–05, SRI managed funds grew by over 2 000 percent.[52] The main factors contributing to this significant increase were large superannuation funds adopting SRI policies for existing portfolios, and the strong investment performance of SRI managed funds.

2.71 A comparison of average investment returns also clearly demonstrates the strong performance of Australian funds managed by 'ethical' investors compared with mainstream investors. Data from the 2005 survey conducted by the EIA indicates that over the longer term the average Australian SRI fund consistently outperformed average mainstream funds and the top 300 corporate index (the S&P/ASX300 Index).[53] For example, when averaged over a five or seven year period SRI funds outperformed mainstream funds and the S&P/ASX300 Index benchmark by around three per cent per annum. Although there is insufficient empirical research to support this view emphatically as yet, based on the evidence so far, the committee is of the opinion that corporations that engage in material corporate responsibility activities

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50 Westpac Banking Corporation, *Submission 94*, pp 13–14.

51 Mr Tony Wood, General Manager, Public and Government Affairs, Origin Energy *Committee Hansard*, 5 April 2006, pp 49–50.

52 Ethical Investment Association, *Sustainable responsible investment in Australia 2005*, p. 5.

53 Ethical Investment Association, *Sustainable responsible investment in Australia 2005,* p. 13.

may better and more completely assess medium and long term risk and business opportunities. This issue is discussed further in chapter 3.

2.72 Although past returns do not guarantee future performance, the sustained positive trend, particularly over the long term, is an encouraging development and lends weight to the connection between good corporate behaviour and strong financial performance. Further discussion of sustainable responsible investment as a driver of corporate responsibility is included in chapter 3, and the influence of SRI on investment decisions by institutional investors is considered in chapter 5.

CHAPTER 3

DRIVERS AND PRINCIPLES OF CORPORATE RESPONSIBILITY

3.1 In the course of the inquiry the committee heard much about the factors that drive 'responsible' and 'sustainable' behaviour on the part of corporations and organisations. In addition, many views were put to the committee regarding the principles that shape, or should shape, engagement with a corporate responsibility agenda.

3.2 This chapter firstly outlines the evidence presented on the drivers of corporate responsibility, and secondly, the views put forward about the principles that should shape the concept of corporate responsibility.

Drivers of corporate responsibility

3.3 Given the traditional focus of corporations has been on generating profit to provide a financial return to shareholders, the question arises: why would a corporation use company resources to undertake activities that are apparently without direct financial return? Alternatively, why would a profit-driven company choose to engage in such activities that have the potential to distract them from pursuing their main business interests and weaken their financial performance?

3.4 In evidence, Mr Cooper, Deputy Chairman of the Australian Securities and Investments Commission (ASIC) succinctly provided one half of the answer when, referring to large global companies, he said 'what is driving them is the realisation that behaving without regard to these sorts of principles causes them *immense commercial damage*.'[1] (emphasis added).

3.5 The other half of the answer lies in the fact that, in an increasingly competitive and globalised marketplace, companies are looking for new ways to create lasting company value. Leading companies in this area have realised that integrating the notion of sustainability and corporate responsibility into their everyday business practices can have a range of benefits for company value. In addition, companies recognise that by paying due attention to their impact on the environment and on the community, future risk to the corporations may be reduced or mitigated. Companies may note the experience of the Hardie Group, whose product range and use many years ago did not appear to foresee future shifts in legal and community standards. Since they were not reporting on risk under a corporate responsibility framework, directors were evidently not alerted in time to the dangers facing the corporation.

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1 Mr Jeremy Cooper, Deputy Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 29 March 2006, p. 24.

3.6 Due to a number of drivers many corporations are finding that there is a growing business case to undertake activities beyond their traditional business interests. The benefits of activities such as working with employees, suppliers, communities and environmental groups are often not immediate and can be intangible, for example employee commitment, consumer trust and corporate brand and reputation. However, as corporate value becomes increasingly dependent on intangible assets, many companies are realising the benefits of better managing their social and environmental risks, with a view to protecting and enhancing these assets and improving their long-term financial viability. Reputational risk is particularly important for many companies. The case of Nike Corporation is often quoted in this regard. Many commentators have noted that Nike's attempt to maximise profit by setting up manufacturing facilities in low-wage countries, and the reporting of its alleged exploitation of third-world workers, resulted in significant brand damage.

3.7 It is apparent that a range of market drivers is responsible for the burgeoning interest in corporate responsibility, and some of these are discussed below.[2] However, it is useful at the outset to make several general observations.

General observations

3.8 Firstly, the dominant motivations for improved sustainability performance are the usual economic forces of informed and competitive commercial markets. The other main motivating factors are the recent changes in community expectations as well as some companies genuinely being committed to ethical decision making or 'doing the right thing'.

3.9 As community and financial market expectations of what constitutes good corporate behaviour change and evolve over time, in most cases corporations respond by modifying their operations and activities accordingly. For example Insurance Australia Group's (IAG) submission recognised that '[s]trong companies are sustained because they understand, and respond to changing customer and community priorities.'[3]

3.10 Companies that embrace the concept of corporate responsibility are realising that the long term financial interests of a company are 'not mutually exclusive'[4] with acting fairly in the interests of stakeholders (other than shareholders).

3.11 Indeed for some companies, considering broader stakeholder interests can have a significant benefit for their long-term financial position. For example, Westpac, a leading proponent of corporate responsibility in Australia, gave evidence of its positive experience in implementing corporate responsibility initiatives:

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2 Many submissions discussed these drivers, for example: Australian Institute of Company Directors, *Submission 73*, p. 8; and Business Council of Australia, *Submission 108*, pp 14–40.

3 Insurance Australia Group, *Submission 29*, p. 1.

4 Business Council of Australia, *Submission 108*, p. 4.

> It became fairly obvious that everything we touched in this area was value adding. I can say right to this point there is nothing Westpac have done in our journey over what is getting close to 10 years with [corporate responsibility] which has not been shareholder value adding. I do not think we know of any case. There can be situations where there is a very short term cost—for example, energy efficient devices in buildings—but the payback period is so rapid that it quickly turns into being a bottom line plus.[5]

3.12 BHP Billiton, another leading Australian company in the area of corporate responsibility, supported this view:

> Rather than proving a burden to our businesses, CSR has been viewed throughout BHP Billiton as critical to our long term success. The BHP Billiton Charter states that we will only be successful when our host communities value our citizenship.[6]

3.13 Secondly, there are connections between the various commercial drivers of improved sustainability performance, and these drivers can be reinforcing in nature. For example a company which proactively manages its material non-financial risks, will in the longer-term improve its competitive position. Similarly a company which considers and where appropriate responds to community and consumer expectations, will enhance its corporate reputation, which should also improve its competitiveness.

3.14 Thirdly, the pressure companies experience from the various drivers is increasing and is likely to continue to increase into the foreseeable future. It will be the companies that respond most effectively to those drivers which will have a competitive edge in the future.

3.15 Finally, it is also apparent that different companies are influenced differently by the drivers depending on company attributes such as the nature of the business, size, location and industry sector. The Business Council of Australia (BCA) submitted:

> The innovative and creative CSR activities being undertaken by Australian companies reflect each company's unique operational experience and expertise. The CSR activities vary depending on the nature of the corporation's activities, their impacts and the communities within which they operate... What is an appropriate CSR activity for the banking sector, for example, will be very different from the activities pursued in the manufacturing sector.[7]

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5 Dr Noel Purcell, Group General Manager, Stakeholder Communications, Westpac Banking Corporation, *Committee Hansard*, 23 November 2005, p. 99. Wesfarmers made a similar observation: see *Committee Hansard*, 20 February 2006, p. 17.

6 BHP Billiton, *Submission 13*, p. 1.

7 Business Council of Australia, *Submission 108*, p. 8.

The next section of this chapter discusses the following drivers of corporate responsibility:

- competitiveness and profitability;
- attracting investment;
- attracting and retaining employees;
- reputation;
- risk management;
- corporate failures;
- community expectations and license to operate;
- avoidance of regulation; and
- globalisation.

Competitiveness and profitability

3.16 As outlined earlier, the underlying catalyst for companies to adopt the concept of corporate responsibility is economic market forces, coupled with community pressure. Companies are becoming increasingly aware that managing non-financial risks and pursuing opportunities to undertake corporate responsibility activities may benefit long-term financial performance. The BCA recognised that '[i]t is simply good business for companies to recognise the impacts they have, the opportunities and risks these present and then to respond effectively.'[8] The BCA identifies competitiveness opportunities such as: developing the economy and community in which it operates; working with government to facilitate better regulatory regimes; integrating environmental breakthroughs into assets to reduce lifecycle costs and improve efficiency; and effective communication with customers.[9]

3.17 The Chamber of Commerce and Industry of Western Australia recognised the potential for both mitigating negative impacts and taking advantage of positive impacts. Its submission stated:

> [t]he commercial incentive is not purely to avoid negative outcomes. Many businesses have implemented triple bottom line accounting and achieved improvements in operating efficiency or savings in input or waste management costs. These measures are adopted by firms because they make good business sense and are in the interest of shareholders.[10]

3.18 The concept of corporate responsibility has created a range of new business opportunities for corporations to increase their competitiveness and profitability. More companies are seeking to improve their competitiveness by taking advantage of

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8 Business Council of Australia, *Submission 108*, p. 14.

9 Business Council of Australia, *Submission 108*, p. 29.

10 Chamber of Commerce and Industry of Western Australia, *Submission 92*, p. 18.

synergies with their broader stakeholder communities. For example, BHP Billiton submitted:

> The dynamic nature [of the corporate responsibility] agenda provides an opportunity for corporate groups such as ours to seek competitive advantage, by exploring new ways of approaching and engaging in relationships with their key stakeholders.[11]

3.19 Westpac also recognised the competitive advantage:

> Sustainability is seen as a competitive differentiator for Westpac. Whereas much of the broad debate on corporate responsibility focuses on risk amelioration, Westpac is very much pursuing the business upside from adopting responsible and sustainable business practices; for example through cost reduction, and pursuing new products and new markets.[12]

3.20 The recent empirical work conducted for the Department of the Environment and Heritage found that issues relating to competitiveness were cited frequently by large companies as the benefits of producing sustainability reports. The four most often cited benefits were reputation enhancement (82%); ability to benchmark performance (68%); operational and management improvements (64%); and improved management of risks (62%).[13] All have some bearing on a company's competitiveness, revenue and profitability.

3.21 The impact on a company's financial performance of 'responsible corporate behaviour' was a recurring theme during the inquiry. In this vein the Prime Minister, the Hon John Howard MP, has previously acknowledged that '[b]eing a good corporate citizen, building trust, engaging with and supporting communities can add value to the bottom line in a variety of ways.'[14]

3.22 The committee was referred to a number of studies which attempt to demonstrate a positive or negative relationship between company financial performance and responsible corporate behaviour. A 2005 study by researchers in the UK investigated the relationship between corporate social performance and financial performance, and found that companies which rated poorly in corporate responsibility terms achieved higher financial returns than those which rated well:

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11 BHP Billiton, *Submission 13*, p. 1.

12 Westpac Banking Corporation, *Submission 94*, pp 10–11.

13 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 32.

14 The Hon John Howard MP, Prime Minister of the Commonwealth of Australia, 'The 1999 Corporate Public Affairs Oration' presented to the Centre for Corporate Public Affairs, 26 March 1999, cited by the Consumers' Federation of Australia , *Submission 89*, p. 6.

> ...firms with higher social performance scores tend to achieve lower returns, while firms with the lowest possible [corporate social performance] scores of zero considerably outperformed the market.[15]

3.23 Alternatively, other research indicated a positive relationship. The results from CPA Australia's *Confidence in Corporate Reporting 2005* survey demonstrate that a significant majority of respondents (86%) agreed with the proposition that 'better management of a company's social and environmental concerns benefits shareholders.'[16] Interestingly, there was general agreement on this proposition from the various classes of respondents which included shareholders, analysts, advisors and brokers, directors, CEOs and CFOs.

3.24 The ASX Corporate Governance Council in its *Principles of Good Corporate Governance and Best Practice Recommendations* also recognised the potential commercial benefits. Principle 10 of the recommendations states:

> There is growing acceptance of the view that organisations can create value by better managing natural, human, social and other forms of capital. Increasingly, the performance of companies is being scrutinised from a perspective that recognises these other forms of capital. That being the case, it is important for companies to demonstrate their commitment to appropriate corporate practices.[17]

3.25 The committee notes that there is a mounting body of anecdotal evidence which suggests a link between companies that take account of broader stakeholder interests and positive long-term financial performance. Several submissions referred to the detailed meta-analysis carried out by Orlitzky and Rynes, which integrates 30 years of research of 52 previous studies.[18] This report, which appears to be the most comprehensive study in the field, concluded that 'corporate social performance and financial performance are generally positively related across a wide variety of industr[ies].'

3.26 KPMG commented that hard proof that corporate responsibility benefits shareholder value remains elusive, but noted that there is a growing body of circumstantial evidence. KPMG indicated the difficulties of drawing a link:

> It has not yet been possible to make a strong, causal, quantitative link between corporate responsibility actions and financial indicators such as

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15 Mr Stephen Brammer, University of Bath; Mr Chris Brooks, Cass Business School; and Mr Stephen Pavelin, University of Reading, *Corporate Social Performance and Stock Returns: UK Evidence from Disaggregate Measures,* June 2005, p. 13.

16 CPA Australia, *Submission 103b*, p. 19.

17 ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 59.

18 For example Dr Zappalà, *Submission 2*, Mr Turner, *Submission 5*, the Hon Dr Ken Coghill, Dr Leeora Black, Mr Dough Holmes, *Submission 71*, Mr Ben Neville, *Submission 87*, and Amnesty International, *Submission 90*.

> shareholder wealth. Some correlations have been shown to exist, but that does not necessarily demonstrate a causal link.[19]

3.27 It should be noted that because of the relatively recent emergence of the concept of corporate responsibility, and the fact that 'responsible corporate behaviour' is said to be a value proposition for companies in the longer-term, it is premature to conclude that there is any definitive connection between 'responsible corporate behaviour' and improved financial performance.

Attracting investment

3.28 The strong performance of sustainable investment funds and the emergence of sustainability market indices provide further evidence of a link between corporate responsibility and positive long-term financial results. Such targeted investment is also one of the strongest drivers of corporate responsibility and is likely to become more influential in the future. This is a classic demand-driven phenomenon. When a significant number of investors put a value on corporate responsibility, corporations respond by trying to satisfy that demand.

3.29 An earlier chapter of this report has referred to the significant increase over recent years in Australian funds managed as sustainable investments (known as Sustainable Responsible Investment (SRI)), outlining increases in SRI in excess of 2000 per cent over the last five years.[20]

3.30 Mainstream investors are also responding to the growing demand for SRI products. The Treasury noted in its submission that '[a]ll four major banks and several of the larger institutional investment houses have introduced socially responsible investment funds.'[21]

3.31 A recent survey of mainstream professional investors found that within five years, 44 per cent of Australian investment managers expect the integration of social and/or environmental corporate performance indices will be common place (and rising to 94 percent within 10 years).[22] This view is further supported by evidence from groups such as the Australasian Investor Relations Association which submitted that 'corporate social performance is increasingly a factor in shareholders' investment decisions and in financing decisions of financial institutions.'[23]

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19 KPMG, *Submission 53*, p. 2.

20 Ethical Investment Association, *Sustainable responsible investment in Australia 2005*, p. 5.

21 Department of the Treasury, *Submission 134*, p. 8.

22 Mercer Human Resources Consulting, *SRI: What so investment managers think?* 21 March 2005, http://mercerhr.be/summary.jhtml;jsessionid=04AXPUGEXMNR4CTGOUGCHPQKMZ0QYI2C?idContent=1174905 (accessed 1 June 2006).

23 Australasian Investor Relations Association, *Submission 97*, p. 2.

3.32 One of the reasons for this trend is that mainstream institutional investors, in seeking to understand better a company's overall risk profile, are giving greater consideration to the business risks posed by environmental and social factors when determining the overall value of a company. These considerations are increasingly being reflected in a company's underlying financial performance. Institutional investors, and their position in relation to corporate responsibility, are discussed further in chapter 5.

3.33 As access to investment capital is extremely important to a company's ability to continue its ongoing activities and to expand into new ventures, companies are giving serious consideration to this new investment market dynamic. In this regard, the ASX's Corporate Governance Council has stated that 'demonstrably good corporate governance practices are increasingly important in determining the cost of capital in a global capital market.'[24]

3.34 A recent KPMG business survey on sustainability reporting in Australia found that 59 per cent of respondents cited 'gain[ing] confidence or investors, insurers and financial institutions' as a key benefit of sustainability reporting.[25]

3.35 The increase in sustainability indices is also an indicator of the investment market's growing interest in good corporate behaviour. According to the Finance Sector Union:

> [t]he growing profile of various ratings agencies who provide assessments of companies' activities according to various ethical, environmental, labour, safety criteria are a strong sign that the market and society are increasingly interested in the 'non-financial' aspects of a company's behaviour.[26]

Attracting and retaining employees

3.36 Many submissions recognised that employees are a strong driver of corporate responsibility. In its submission, ANZ recognised the contribution of employees, stating that 'arguably our people invest more in the company than the shareholders'.[27] Companies seeking to be an 'employer of choice' are using corporate responsibility initiatives to bolster their claim. In particular, submitters indicated that corporate responsibility improved three important aspects of developing and maintaining a high-quality workforce: recruitment, motivation and retention of staff.

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24 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 4.

25 KPMG, *Submission 53*, p. 3. The report, *The State of Sustainability Reporting in Australia 2005*, was commissioned by the Department of the Environment and Heritage and is available from http://www.deh.gov.au/settlements/industry/corporate/reporting/survey.html.

26 Finance Sector Union of Australia, *Submission 24*, p. 3.

27 ANZ, *Submission 101*, p. 3.

Recruitment

3.37 Employees are becoming more discerning of a prospective employer's responsible workplace practices (such as corporate volunteering and giving programs) as well as its broader social and environmental performance. For example, KPMG noted:

> [a] new generation of employees, and especially graduate recruits are more acutely aware of social responsibility and care about how potential employers go about their business.[28]

3.38 This view was supported by the Australian Institute of Company Directors (AICD) which stated:

> [s]ometimes now you get employees that you are recruiting asking you what you do in [the area of corporate responsibility], because they want to feel proud about the organisation that they join. So there is that positive pressure.[29]

Motivation

3.39 Maintaining employee motivation was cited by the BCA as a driver for corporate responsibility. BCA quoted Mr John McFarlane, ANZ CEO:

> Turning staff into stakeholders… How people feel about working at an organization and how passionate and engaged they are in its agenda, is what makes the difference between good and great companies.[30]

3.40 The partnership between the ANZ Mortgage Group and Habitat for Humanity Australia provided an excellent example of the way in which a company's social engagement can improve staff morale:

> Through our day to day business at ANZ Mortgage Group, we put more than 150,000 families into homes each year. And, yet, the support we provide to Habitat for Humanity Australia, which enables it to place but three families in homes each year, touches the hearts and minds of our staff significantly more.
>
> Our association with Habitat for Humanity Australia has enabled our staff, through their generosity of spirit, to help with the projects and to touch the lives of those families in need—often in small ways, but making a huge difference to those families.[31]

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28 KPMG, *Submission 53*, p. 1.

29 Mr Tony Berg AM, Member, Corporate Governance Committee, Australian Institute of Company Directors, *Committee Hansard*, 23 November 2005, p. 95.

30 Business Council of Australia, *Submission 108*, p. 16.

31 Habitat for Humanity, *Submission 125*, p. 13, quoting Mr Chris Cooper, Managing Director, ANZ Mortgage Group.

Retention

3.41 In evidence, Westpac provided the example of paid maternity leave as one way it responds to the driver of staff retention:

> It costs us about $50,000 or $60,000 to replace somebody, basically, by the time they are trained, accredited and brought up to standard. We are talking about why paying maternity leave is a positive value generator for us compared to where we were, and how that has absolutely increased the return-to-work rate and retention.[32]

3.42 Alcoa supported this view and has implemented a number of programs to support flexible workplace arrangements which are said to 'not only promote a diverse workforce, they also help retain valuable corporate experience and knowledge.'[33]

3.43 Employment considerations such as recruitment, motivation and retention are likely to become a more influential driver of corporate responsibility as competition for talented and experienced employees intensifies and as labour markets are further liberalised.

Reputation

3.44 Corporate reputation has become one of the more valuable intangible company assets. A strong company reputation provides a real opportunity for brand differentiation in increasingly commoditised markets.

3.45 Maintaining and improving company reputation was cited by the majority of submissions as a key driver of corporate responsibility. This view is supported by the KPMG Australian company survey, which showed that reputation enhancement was the most popular key benefit of sustainability reporting (cited by 86% of respondents).[34] In its submission, KPMG also made the point that intangible assets such as reputation underlie the value of a company's physical assets.[35]

3.46 The issue of reputation management is treated very seriously by companies such as Shell Australia. Shell summarised the impact of reputational risk in the following way:

> Those companies that [manage well their approach to corporate social responsibility, sustainable development and to reputation enhancement] will be ultimately rewarded for doing so, while those that don't will suffer the reputational and, ultimately, business costs for not doing so.[36]

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32 Dr Noel Purcell, Group General Manager, Stakeholder Communications, Westpac Banking Corporation, *Committee Hansard*, 23 November 2005, p. 106.

33 Alcoa World Alumina Australia, *Submission 78*, p. 13.

34 KPMG, *Submission 53*, p. 3.

35 KPMG, *Submission 53*, p. 1.

36 The Shell Company of Australia, *Submission 74*, p. 9.

3.47 Shell's submission went on to explain that:

> in Australia, the Chairman has specific tasks under the terms of his appointment which require him to provide assurance to [the Shell parent company] that due attention has been given to the interests of stakeholders as an essential part of managing Shell's reputation.[37]

3.48 The association between a company's reputation and its non-financial risk and performance was highlighted by BT Governance Advisory Service (BTGAS):

> Companies that do not manage community, customer and employee expectations are exposed to boycotts, protests and negative media attention all of which lead to reputation damage for the company.[38]

3.49 Corporate decision-making that ignores or disregards social and environmental impacts can very rapidly tarnish a company's good reputation, a reputation that may have taken years to develop. Recent corporate scandals clearly demonstrate how companies that disregard the social and environmental impacts of their actions risk their sales performance, share price, and regulatory intervention.

3.50 Even the threat of litigation can be damaging to a company's reputation. A recent report on the increased risk of litigation against corporations in environmental areas (such as climate change) and social areas (such as human rights) points out that litigation can be damaging to a company's reputation even when the litigation is unsuccessful.[39] Acquittal of itself is not necessarily a shield against the risk of reputational damage.

Risk management

3.51 Risk management and minimisation was mentioned by many participants in the inquiry as a driver for corporate responsibility. Research and rating consultants RepuTex defined corporate and social responsibility in terms of risk management:

> [Corporate responsibility] may be ... defined as a form of management to minimise conventional notions of non-financial risk in areas such as governance, environmental and social impact and workplace practices. Sound management in such areas controls risk, increases productivity and provides enhanced business opportunities. Companies which engage with the community and adopt a sincere CSR management approach gain an advantage from an enhanced capacity to be aware of and control risk associated with new or altered demands from government regulators, employees, community stakeholders, shareholder activists and consumers.[40]

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37 The Shell Company of Australia, *Submission 74*, p. 9.

38 BT Governance Advisory Service, *Submission 19*, p. 1.

39 SustainAbility, *The Changing Landscape of Liability: A Director's Guide to Trends in Corporate Environmental, Social and Economic Liability*, January 2005.

40 RepuTex Ratings & Research Services, *Submission 86*, p. 2.

3.52 RepuTex also expressed the view that companies managing their non-financial risk were better placed competitively than those who did not:

> Minimising non-financial risk ultimately places a company in a stronger, more sustainable market position than an unengaged competitor who is likely to be exposed to a greater number of external variables.[41]

3.53 BTGAS argued that risk management involved managing stakeholder expectations:

> We believe that companies that manage their stakeholders' interests are managing their shareowners' interests, especially over the long-term. This arises from the fact that risks to companies arise not just from typical financial risks but also from regulatory, community and litigation risks. By managing stakeholder expectations, companies begin to manage many of these risks.[42]

3.54 BTGAS went on to comment that not all companies are managing non-financial risks as well as they could, and that:

> Organisational decision makers need to pay more attention to longer term sustainability and governance risks that give rise to community, regulatory and litigation risks.[43]

3.55 The Chamber of Commerce and Industry Western Australia argued that investment analysts were taking account of a company's management of its non-financial risks:

> More hard-nosed corporate investment analysts have also turned their attention to the social, ethical and environmental practices of the businesses they invest in, driven not so much by desire to penalise behaviour deemed immoral, as by concern for the financial risks associated with it. In part this may reflect under-estimation of risk in the past. But it seems to be driven more by the fact that the financial penalties associated with being held guilty of improper behaviour are much greater than ever before, whether guilt is in the eyes of the public, NGOs, or the courts. Boards and directors, as well as shareholders and investment analysts, are reacting to this changed risk environment.[44]

3.56 Corporate responsibility has encouraged corporations to move into performance audits. Traditionally (unlike the public sector) corporations have focussed almost entirely on financial audits, so avoiding broader risk appraisal. Performance audits are better at exposing longer term risks than financial audits.

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41 RepuTex Ratings & Research Services, *Submission 86*, p. 2.

42 BT Governance Advisory Service, *Submission 19*, p. 2.

43 BT Governance Advisory Service, *Submission 19*, p. 3.

44 Chamber of Commerce and Industry of Western Australia, *Submission 92*, p. 9.

Corporate failures

3.57 Another factor influencing the take-up of a corporate responsibility agenda has been the reaction to recent corporate scandals and collapses. A number of submissions referred to cases such as HIH in Australia, and Enron and WorldCom in the US, which have influenced perceptions of corporations by the community, by other corporations, and by financial markets.

3.58 Mr Turner argued that poor corporate behaviour has raised the profile of the corporate responsibility movement:

> The corporate social responsibility (CSR) movement ... has gained momentum through corporate disasters such as the Exxon-Valdez oil spill in Alaska in 1989, the increased strength of non-governmental organisations (NGOs) and publicity given to anti-globalisation and anti-big business movements. When added to the general increase in the social and environmental conscience of society, and all time low consumer trust of big business following the corporate collapses and accounting scandals of the last five years, CSR has emerged as the debate of the next decade.[45]

3.59 Ms Cox referred to the effect these collapses have on organisations and the pressures created for greater accountability:

> The collapses a few years ago of some large corporations and the problems others have with their reputations ... raise some serious questions about ethics and how organizational cultures affect corporate structures and governance. These added to increasing political and consumer pressures on both commercial and non commercial organizations and corporations for greater accountability and transparency.[46]

3.60 Corporate failures and scandals have led for calls for increased regulation by governments and market regulators, and this in itself can prompt some corporations to engage more with a corporate responsibility agenda, in order to forestall regulatory responses.

3.61 The investment sector has also responded to corporate collapses. A submission from researchers at Monash University argued that in the wake of several high profile corporate collapses there is an increasing tendency for institutional investors to take a more activist stance, thus creating a push for responsible corporate behaviour.[47] The researchers noted, however, that:

> To date however, such engagement has tended to be ad hoc and reactionary, occurring after the event or in response to stakeholder pressure rather than an integral component of investment strategy.[48]

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45 Mr Richard Turner, *Submission 5*, p. 2.

46 Ms Eva Cox, *Submission* 26, p. 1.

47 The Hon Dr Ken Coghill, Dr Leeora Black, Mr Doug Holmes, *Submission 71*, p. 56.

48 The Hon Dr Ken Coghill, Dr Leeora Black, Mr Doug Holmes, *Submission 71*, p. 48.

Community expectations and licence to operate

3.62 The concept of a company's 'community' or 'social' 'license to operate' was raised in several submissions. By effectively engaging with the communities in which they operate, companies gain tacit permission to continue in operation. BTGAS provided this description:

> Community risk: community stakeholders often determine what is referred to as a ‘social license to operate’. If companies do not manage the expectations of the communities in which they operate they will not retain or gain the social license necessary for operation.[49]

3.63 A community licence to operate was mentioned with particular reference to the mining industry. The Centre for Corporate Public Affairs related how:

> The mining industry in Australia was one of the first sectors to lead the way in CSR activity in the 1970s and early 1980s, after stakeholders demanded it better engage the communities in which it operated. The key issues the community wanted addressed were land access, indigenous employment and environmental impact. These issues were linked with the social and community license to operate.[50]

Avoidance of regulation

3.64 The desire by business to avoid regulatory responses by governments was also identified as a driver of corporate responsibility. By taking voluntary action to improve corporate conduct, corporations may forestall regulatory measures to control their conduct. The BCA submitted:

> Poor corporate behaviour ... increases the risk of regulatory intervention by Governments. In most cases, it will be less costly for corporations to resolve issues themselves, rather than have regulation imposed. Even where regulation is being imposed, the standing of corporations in the community will determine their ability to influence the regulatory outcome. Poor corporate behaviour therefore increases regulatory risk.[51]

3.65 BTGAS commented:

> Regulatory risk arises when community risks are so great governments respond by developing policies and regulatory mechanisms to curb a particular activity or introduce taxes or pricing incentives to restructure the burden of the costs away from external stakeholders and towards the business. This not only has the potential to create direct cost imposts on a company but also increases the transition costs through compliance with the regulation.[52]

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49 BT Governance Advisory Service, *Submission 19*, p. 1.

50 Centre for Corporate Public Affairs, *Submission 135*, p. 3.

51 Business Council of Australia, *Submission 108*, p. 27.

52 BT Governance Advisory Service, *Submission 19*, p. 1.

3.66 The Prime Minister recognised this risk of increased regulation in a 1999 speech:

> Companies and industries which are trusted and respected in the community for doing the right thing are likely to find themselves less constrained by government pressures or regulatory intervention, or pressure from interest groups and the community generally.[53]

Globalisation

3.67 Globalisation was raised as a factor driving corporate responsibility, influencing the corporate response in several different ways. Mr Cooper of ASIC argued that the forces of globalisation were one factor that was already driving corporate responsibility.[54] Mr Cooper pointed out that companies with operations in several countries were influenced by trends and regulatory systems around the world. He used the example of BHP Billiton:

> [BHP Billiton] operates around the world, including in the US, so as an entity it absorbs a lot of these principles of regulatory systems. What tends to happen is that it brings the whole entity up to the highest level of regulation in any one of those areas...[55]

3.68 Oxfam noted that the increasing conduct of business on a global basis has been a driver for corporate responsibility. Oxfam's Mr Ensor expressed the view that much of the trend towards adopting a corporate social responsibility agenda has been in response to the recognition by global companies that poor environmental and social performance can affect bottom lines.[56] He told the committee:

> [the initiative around the CSR agenda] ... has occurred principally in Europe. A lot of it has been driven from Europe [and] because of the globalised nature of business, the joint listing of companies on various stock exchange indices across Europe, the US, the UK, and Australia, that has been part of the driver. ...[O]ur experience is that, relatively speaking, the better performance tends to be with globalised companies with very high brand risk profiles in terms of reputation that can translate into the bottom line very quickly.[57]

3.69 The Australasian Investor Relations Association pointed out that when looking for investment opportunities globally (including in Australia), the

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53 The 1999 Corporate Public Affairs Oration presented to the Centre for Corporate Public Affairs by the Prime Minister, the Hon John Howard MP, Melbourne, 26 March 1999, available at http://www.pm.gov.au/News/Speeches/1999/corppubaffairs2603.htm.

54 Mr Jeremy Cooper, Deputy Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 29 March 2006, p. 11.

55 *Committee Hansard,* 29 March 2006, p. 23.

56 Mr James Ensor, Director, Public Policy and Outreach, Oxfam Australia, *Committee Hansard,* 24 February 2006, p. 35.

57 *Committee Hansard,* 24 February 2006, pp 35–36.

international investment sector was influenced by the non-financial, sustainability performance of companies.

> ...at the end of the day the investment community increasingly is a global industry and it looks for the same types of [non-financial] information. Whether it be an analyst sitting in Boston or a fund manager sitting in Frankfurt or a fund manager sitting in Melbourne, they do consider the same sorts of information sets whether financial ... or, increasingly, non-financial. Perhaps to a lesser extent it is non-financial but I think the information that the investment community and other stakeholders are looking for is largely the same.[58]

3.70 The free flow of information globally was also cited by some as an influencing factor. Mr Ensor of Oxfam described how modern technology facilitated the rapid flow of information, and also facilitated the involvement of the media in reporting company behaviour:

> One of the fundamental drivers of this agenda is [the] element of globalisation that enables there to be such a rapidly instantaneous flow of information analysis around the world. I can receive an email from a remote village in the middle of West Papua containing detailed information about an event that may have happened two or three hours ago. I have the capacity to get that information on to page 1 of the New York Times within a 10- or 12-hour period in theory. That aspect of globalisation has fundamentally driven the CSR agenda.[59]

3.71 Finally, globalisation is significantly increasing the rate of sustainability reporting observed in Australia. According to a recent study by the Centre for Australian Ethical Research, the rate of production of sustainability reports by foreign owned companies operating in Australia is more than twice that of Australian owned companies.[60]

Principles of corporate responsibility

3.72 The evidence presented to the committee on factors that drive corporate responsibility indicates that there is a wide range of influences governing the behaviour of companies and organisations. Also emerging from the evidence were some common themes regarding the principles that should underlie corporate responsibility. This section discusses these principles.

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58 Mr Ian Matheson, Australasian Investor Relations Association, *Committee Hansard,* 27 March 2006, p. 5.

59 Mr James Ensor, Director, Public Policy and Outreach, Oxfam Australia, *Committee Hansard*, 24 February 2006, p. 35.

60 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 27.

Business led or government led?

3.73 A theme emerging in evidence to the committee was an industry preference for corporate responsibility to be led by business, and not imposed by government. Evidence regarding factors that drive corporate responsibility presented earlier in this chapter indicates that long-term sustainability practices are already being taken up by business, responding largely to market forces, rather than to any push from government.

3.74 Ms Mostyn of IAG told the committee that government had a role in providing the right environment for companies to engage with sustainable business practices:

> [by] providing an environment where companies are encouraged to create innovative corporate responsibility and sustainability approaches by providing for flexibility, competitive and market led developments.[61]

3.75 Similarly, GlaxoSmithKline representative Mr Gosman expressed support for government activities that encouraged corporate responsibility:

> We believe that the role of government is essentially one of encouragement rather than mandatory reporting or the prescribing of activities. In that respect, activities that encourage companies to take an interest in this area, such as the Prime Minister's corporate social responsibility awards, are what we believe is needed to go forward. We very much favour a voluntary approach rather than a mix of prescriptive or proscriptive regulations.[62]

3.76 The role of government in encouraging corporate responsibility is discussed in some detail in chapter 8.

Mandatory or voluntary?

3.77 Central to the question of business versus government as the driver for corporate responsibility is the issue of whether sustainable behaviour should be mandatory or voluntary. The committee received much evidence regarding the appropriateness of measures to mandate corporate responsibility and was told more than once that it is not possible to mandate good corporate behaviour. For example, Westpac's Dr Purcell argued that:

> ...it is difficult, if not impossible, to mandate good values based business behaviour through legislation or regulation—and there are plenty examples of that. In the future if there is inadequate corporate progress in adopting

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61 Ms Sam Mostyn, Group Executive, Culture and Reputation, Insurance Australia Group, *Committee Hansard*, 9 March 2006, p. 4.

62 Mr Alex Gosman, Director, Government and Corporate Affairs, GlaxoSmithKline, *Committee Hansard*, 23 February 2006, p. 44.

> responsible business practices there may be a case for considering non-prescriptive type approaches.[63]

3.78 The St James Ethics Centre expressed the view that mandating corporate responsibility was not appropriate:

> We believe that the use of legislation, regulation and surveillance as the principal means for protecting the interests of stakeholders other than shareholders is misguided. ... an over-reliance on such an approach is largely ineffective because it invites a negative culture of compliance characterised by indifference to the principles that inform the legislation or regulations.[64]

3.79 Some evidence to the committee questioned whether voluntary mechanisms were sufficient. The Brotherhood of St Laurence, for example, commented that:

> ...many of the initiatives taken by enterprises to demonstrate that they are good corporate citizens or to demonstrate their commitment to CSR have been through the introduction and application of voluntary mechanisms. While voluntary mechanisms are a useful starting point and a useful tool to help harness an enterprise's thinking about CSR, we have seen that in reality they are not adequate to guarantee that an enterprise's risk management strategies will be met, their brand will be protected and ... in supply chain management, labour standards will be upheld.[65]

3.80 The Australian Network of Environmental Defenders Offices also doubted the effectiveness of voluntary mechanisms, and argued in favour of regulation:

> The position at the moment ... is essentially based on voluntary codes and mechanisms of that ilk. Such codes, as we have seen, are not binding. They are practised by a few large corporations, and they are not regularly independently monitored. Such codes are problematic. I think most people, and perhaps even corporations privately, would concede that fact. We need to move beyond this to clear and enforceable rules that would allow for a level playing field and produce better outcomes.[66]

3.81 The mandatory versus voluntary debate is discussed further elsewhere in this report. It is discussed in chapter 4 in the context of directors' duties, in particular the option of changing those duties to require that the interests of stakeholders other than shareholders be taken into account. A discussion of mandatory versus voluntary sustainability reporting is included in chapter 7.

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63 Dr Noel Purcell, Group General Manager, Stakeholder Communications, Westpac Banking Corporation, *Committee Hansard*, 23 November 2005, p. 98.

64 St James Ethics Centre, *Submission 50*, pp 5–6.

65 Ms Serena Lillywhite, Manager, Ethical Business, Brotherhood of St Laurence, *Committee Hansard*, 24 February 2006, pp 19–20.

66 Mr Jeffrey Smith, Chief Executive Officer, Australian Network of Environmental Defenders Offices, *Committee Hansard*, 9 March 2006, p. 111.

A medium to long-term outlook

3.82 Another theme emerging in evidence was that there was a tendency for capital markets to focus on companies' short-term gains, which militated against the medium to long-term view of sustainability and profitability that was required to engage with a corporate responsibility agenda. This 'short-termism' was raised by many submitters as a barrier to increasing the uptake of sustainable behaviour.

3.83 Mr Berg of the AICD told the committee that there are a lot of pressures in the market for short-term financial performance:

> Companies are being encouraged to give guidance as to what their results will be and then obviously there is a lot of pressure to meet the guidance that has been given. The markets have tended to punish companies that fall short of profit forecasts, whether they have given the guidance or whether it has just been the market forecast. Their share price is often punished quite severely when they fall short. Inevitably amongst top management and boards there is quite a focus on that short-term performance.[67]

3.84 Ms Mostyn of IAG echoed this view, and pointed out that pressure for short-term performance was great when shares were traded on a daily and hourly basis:

> [There is a] need to get away from this rampant short termism that is driven by markets where trillions of dollars are washed in and out through day traders where it does not matter that we have a long term view; they are looking at a share price differential on a daily, or even hourly, basis.[68]

3.85 Mr Mather of BTGAS even pointed out that existence of so-called 'minute traders' or 'minute investors', 'seeking to arbitrage a moment in time.'[69]

3.86 Other market forces are also apparent that encourage a short term view. Directors and senior executives are often provided incentives through their remuneration arrangements to pursue short term company profits. The committee heard evidence that these incentives can negatively impact a company's long term performance. On the other hand, the committee also heard evidence that some companies are making a positive link between corporate responsibility performance and remuneration packages. For example:

> there is one building materials company that I can think of whose chief executive suffers a seven per cent diminution in their performance bonus for a death in the workplace, and that is cumulative. So, in that instance—

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67 Mr Tony Berg AM, Member, Corporate Governance Committee, Australian Institute of Company Directors, *Committee Hansard*, 23 November 2005, p. 90.

68 Ms Sam Mostyn, Group Executive, Culture and Reputation, Insurance Australia Group, *Committee Hansard*, 9 March 2006, p. 16.

69 Mr Erik Mather, BT Governance Advisory Service, *Committee Hansard*, 10 March 2006, p. 68.

> and this is an adverse example—if 13 people died, you would get no bonus.[70]

3.87 However BTGAS pointed out that this was the exception rather than the rule.

3.88 Ms Mostyn of IAG argued that markets needed to take a longer term view:

> Corporate responsibility and sustainability only work if those markets begin to take notice of these issues and move their investments accordingly and show the value over time to their investors.[71]

Integration into company core business and strategy

3.89 Evidence received by the committee over the course of the inquiry strongly underlined the importance of integrating the consideration of broader community interests into the core business strategy of companies, if corporate responsibility was to succeed.

3.90 A number of companies told the committee that corporate responsibility was central to their core business, rather than being an add-on or a 'sideshow'. For example, IAG told the committee:

> We actively make sustainability central to our core business by embracing opportunities and managing risks deriving from the full range of economic, environmental and social factors that interact with and impact on our operations every day.[72]

3.91 The National Australia Bank emphasised that corporate responsibility was not a side function:

> By having CSR embedded into our group strategy function ... the two are intertwined and that we cannot look at strategic issues, such as how we expand, without taking into account CSR. We have not made it a side function; we have integrated it with our group strategy activities and given it significant prominence organisationally.[73]

3.92 The ANZ Bank also took this view:

> The core point from ANZ’s perspective is that what we have sought to do at ANZ is infuse our business strategy with corporate responsibility issues or perspectives as opposed to the reverse, which is to have a stand-alone corporate responsibility strategy. We have sought to integrate the relevant

70 Mr Erik Mather, BT Governance Advisory Service, *Committee Hansard,* 10 March 2006, p. 72.

71 Ms Sam Mostyn, Insurance Australia Group, *Committee Hansard*, 9 March 2006, p. 16.

72 *Committee Hansard*, 9 March 2006, p. 3.

73 Mr Cameron Clyne, Executive General Manager, Group Development, National Australia Bank, *Committee Hansard*, 5 April 2006, p. 6.

issues into our business strategy and make them a very important part of that approach.[74]

3.93 Westpac said of its approach:

> Corporate responsibility is at the heart of Westpac's business model. Consequently, there is no corporate responsibility or sustainability strategy as such; rather this is integrated into the core business strategy. In turn, corporate responsibility is built into strategic decision-making across the business.[75]

3.94 Wesfarmers' representative Mr Kessell emphasised the importance of embedding sustainability reporting mechanisms into company culture:

> I have no hesitation in saying that [data collection, analysis and reporting] is now totally a part of the culture of the company, right from the managing director of Wesfarmers, through his managing directors into the general managers and down to supervisors, who are asked to provide the data to go into this report. It is part of the way of doing business.[76]

3.95 Despite the positive approaches taken by some companies, some submitters expressed concern that Australian companies were lagging behind in engaging properly with corporate responsibility. Mr O'Donoghue of the Australian Council of Social Service (ACOSS), which conducted extensive research into rates of workplace giving in 2005, told the committee:

> In our view, corporate social responsibility should be seen as part of good governance. I think that Australia has got a long way to go in terms of integrating corporate social responsibility initiatives into general decision making and good governance in corporations.[77]

3.96 The Smith Family supported an increase in the number of companies moving towards integrating corporate responsibility into their core business:

> ...the Smith Family supports and encourages the position that the time has arrived for a greater number of Australian companies to move from viewing CSR as a minimum standard to an integrated component of strategy and operations in providing leadership in the continuing development of a distinctive model of corporate social responsibility.[78]

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74 Mr Gerard Brown, General Manager, Corporate Affairs, Australia and New Zealand Banking Group, *Committee Hansard*, 5 April 2006, p. 35.

75 Westpac Banking Corporation, *Submission 94*, pp 10–11.

76 Mr Keith Kessell, Executive General Manager, Corporate Affairs, Wesfarmers, *Committee Hansard*, 20 February 2006, p. 48.

77 Mr Philip O'Donoghue, Deputy Director, Australian Council of Social Service, *Committee Hansard*, 23 November 2005, p. 65.

78 Dr Robert Simons, National Manager, Strategic Research and Social Policy, The Smith Family, *Committee Hansard*, 23 November 2005, p. 56.

Corporate responsibility is an evolutionary process

3.97 A strong message from the evidence received was that progress towards sustainable corporate behaviour for corporations is an evolutionary process, which requires flexibility to respond to changing expectations of the community, employees, and other stakeholders.

3.98 BHP Billiton described how influences such as community expectations shaped its approach to corporate responsibility:

> BHP Billiton's approach to Corporate Social Responsibility ("CSR") and associated public reporting has evolved over time, in step with our own experiences and perceptions of the environment within which we operate, community expectations communicated to BHP Billiton and, in some instances, regulatory requirements.[79]

3.99 Many companies used the analogy of a 'journey' when referring to their experiences with adopting responsible corporate practices and integrating them into core business. Ms Sheehan of Holden GM described that company's journey:

> Corporate social responsibility is a journey. ... [P]rior to 2001 our community programs were fairly ad hoc—it was basically chequebook philanthropy. What we wanted to do was try and come up with something that was better aligned with our business strategy. When we reviewed our community relations programs we decided that we should try and develop priority areas that were actually linked to the brand and to our business strategy. As we go down that corporate responsibility journey, that will get a better buy in from our stakeholders, including our internal stakeholders—our employees and the board.[80]

3.100 NAB representatives also referred to the journey of corporate responsibility:

> We recognise that it is a continuing journey... It is evolving all the time. The benchmark for what is good disclosure is moving all the time and so we have made a commitment to basically take ourselves on a continuous journey, improving where we can as we go.[81]

3.101 ANZ representatives told the committee that ANZ's corporate responsibility journey was one that unfolded over time, rather than being well-planned.[82] ANZ also referred to the impediments in changing company and staff practices, engaging with

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79 BHP Billiton, *Submission 13*, p. 1.

80 Ms Catherine Sheehan, National Manager, Corporate Responsibility, General Motors Holden, *Committee Hansard*, 5 April 2006, p. 29.

81 Ms Rosemary Bissett , Group Manager, Corporate Social Responsibility, National Australia Bank, *Committee Hansard*, 5 April 2006, p. 12.

82 Ms Jane Nash, Head of Government and Regulatory Affairs, Australia and New Zealand Banking Group, *Committee Hansard*, 5 April 2006, p. 44.

the community and empowering local branch staff. ANZ representative Mr Brown likened the process to changing the course of a supertanker:

> Organisations like ANZ are supertankers and they take a long time to turn around. Whilst we have started down that pathway, we still have a long way to go. ...[T]hings take a long time to flow through.[83]

3.102 Unilever Australasia referred to the 'long journey' of bringing capital markets to an understanding of the long-term benefits of sustainable practices.[84] This journey then is one undertaken not only by companies and their employees, but also by other stakeholders, such as institutional investors.[85]

One size doesn't fit all

3.103 The committee heard repeatedly that the 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 and any mechanisms used to encourage it.

3.104 The Australian Banker's Association emphasised that all companies were different, and that stakeholder interests could also be different:

> It is important to recognise that for companies to deliver greatest value for all stakeholders, a “one size fits all” approach does not adequately recognise the diverse and complex needs of all stakeholders. A “one-size-fits-all” approach to corporate responsibility or sustainability will not work due to the uniqueness of each business and the variation in strategic approach across companies. The dynamics of the relevant industry, market sector, operating environment, product or service means that each company is different. The real and comparative influence of, and priority assigned to, varying stakeholder interests will be different.[86]

3.105 GlaxoSmithKline also argued against a one-size-fits-all approach:

> We recognise that the concept of corporate social responsibility will mean different things for companies of different sizes and different sectors. Therefore, it is not really appropriate to have the one size fits all. ....appropriate types of corporate social responsibility activities will vary greatly across sectors. What makes sense to an organisation involved in the

83 Mr Gerard Brown, General Manager, Corporate Affairs, Australia and New Zealand Banking Group, *Committee Hansard*, 5 April 2006, p. 43.

84 Mr Nicholas Goddard, Corporate Relations and Communications Director, Unilever Australasia, *Committee Hansard*, 9 March 2006, p. 8.

85 Ms Linda Funnell-Milner, Corporate ResponseAbility, *Committee Hansard,* 10 March 2006, p. 36.

86 Australian Banker's Association, *Submission 106*, p. 15.

> health care industry could be quite different to what makes sense to [those in] the resources industry.[87]

3.106 GlaxoSmithKline's submission commented that one-size-fits-all legislative approaches ran the risk of constraining other possible responses.[88]

Cost-effective, comparable, and transparent sustainability reporting

3.107 Other principles that emerged during the inquiry related primarily to sustainability reporting. Many submitters argued that any sustainability reporting mechanisms, whether voluntary or mandatory, had to be cost-effective, comparable across companies, and transparent. These issues are discussed separately in chapter 7.

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87 Mr Alex Gosman, Director, Government and Corporate Affairs, GlaxoSmithKline, *Committee Hansard*, 23 February 2006, p. 45.

88 GlaxoSmithKline, *Submission 49*, p. 3. See also the Group of 100 *Submission 27*, p. 3.

CHAPTER 4

DIRECTORS' DUTIES

A director ... of a corporation must exercise their powers and discharge their duties with ... care and diligence.[1]

4.1 Term of reference (c) for this inquiry requires the committee to consider 'the extent to which the current legal framework governing directors' duties encourages or discourages them from having regard for the interests of stakeholders other than shareholders'. In this chapter the committee examines the duties currently imposed on directors by the *Corporations Act 2001* (Corporations Act), and considers whether those duties have any impact on corporate responsibility. Other social and environmental laws require corporations to attend to key social and environmental matters. Directors' duties as presently described already require directors and corporations to observe these laws, however corporations are not necessarily disclosing compliance. During the inquiry, submissions and witnesses proposed several options for changes to directors' duties. The final part of this chapter examines some of those proposals for change. The general view of the committee is that a change to directors' duties is not the best way to encourage corporate responsibility among Australian companies.

The current legislative framework

4.2 Subsection 180(1) of the *Corporations Act 2001* sets out an objective standard for the performance of directors' duties in the following terms:

> A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:
>
> (a) were a director or officer of a corporation in the corporation's circumstances; and
>
> (b) occupied the office held by, and had the same responsibilities within the corporation as, the director or other officer.

4.3 In *ASIC v Adler*, Santow J of the NSW Supreme Court reviewed the authorities and set out a number of principles which flow from this subsection. Prominent among these are the following:

- Directors owe a duty of care and skill, but this duty is not properly a fiduciary duty; and
- By becoming a director, a person implies that he or she has the skills of a reasonably competent person in his or her category of

1 *Corporations Act 2001*, ss. 180(1).

appointment and that he or she will act with reasonable care, diligence and skill; and

- A director should take reasonable steps to place themselves in a position to guide and monitor the management of the company.[2]

4.4 These provisions are sensible provisions which allow investors to invest in a company on the understanding that the company directors will manage the company in the interests of its shareholders. When a shareholder invests in a company, they are in one sense investing in the capacity of the directors and managers to operate the company. Consequently they must have confidence that the directors are using their invested funds for the benefit of the company, and not for other purposes. In his submission, Mr Bill Beerworth states:

> Investors entrust their savings to corporate managers on the implicit promise that they will be increased in value through a mixture of earnings and capital gains.
>
> All new capital raisings and every element of the securities industry are predicated on this core investor promise. If investors did not believe in this promise, they would invest elsewhere or they would not invest at all. [3]

4.5 Section 181 of the *Corporations Act 2001* adds to this a requirement of good faith. It states:

> (1) A director or other officer of a corporation must exercise their power and discharge their duties:
>
> (a) in good faith in the best interests of the corporation; and
>
> (b) for a proper purpose.

4.6 It should be noted that section 181 requires the duty of good faith in the best interests of the *corporation*, not in the best interests of the shareholders. These two will often be contiguous. However, there are cases where directors acting in the best interests of the corporation, will be acting in a manner contrary to the best interests of at least some shareholders. For instance, if directors make a decision which is in the long term interests of the company, benefiting long term and future shareholders, but which results in a short term loss (and a short term decline in share value for current shareholders), then this decision will be in the interests of the company, but will be unwelcome news for shareholders who have taken a short term, perhaps speculative position.

The business judgment rule

4.7 Subsection 180(2) of the *Corporations Act 2001* sets out what is commonly known as the 'business judgment rule'. The business judgment rule is essentially a

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2 ASIC v Adler [2002] NSWSC 171 at [372] per Santow J, paraphrased and references omitted.

3 Beerworth & Partners, *Submission 82*, p. 1.

process by which a director may argue that they have met the duty of care and skill required of them under subsection (1). A director can rely on the business judgment rule if they set out, in relation to the judgment in question, that they:

> (a) make the judgment in good faith for a proper purpose; and
>
> (b) do not have a material personal interest in the subject matter of the judgment; and
>
> (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
>
> (d) rationally believe that the judgment is in the best interests of the corporation.[4]

4.8 Again, it can be seen that paragraph (d) relates to the best interests of the corporation, not the best interests of the shareholders.

4.9 In their submission, Freehills Lawyers commented on the court's application of the business judgment rule as follows. Their focus was particularly on corporate *philanthropy* rather than corporate responsibility, but the analysis remains useful:

> Courts are generally reluctant to interfere in matters that involve the exercise of a commercial judgment, especially where a range of decisions could have been made by a director in a particular circumstance. This is likely to be the approach taken by a court if a reasonable corporate donation was ever challenged in Australia. Charitable donations by their nature often accrue intangible benefits to a company, making the reward for the company difficult to measure. For example, the result of philanthropy may be increased goodwill to the business, improved reputation or a long-term shift in the well-being of the community where the business operates. If a decision has been made to donate to a charity for these reasons, courts will be cautious in second guessing the business decision of the directors.[5]

4.10 On 7 April 2006, the Parliamentary Secretary to the Treasurer, the Hon Mr Chris Pearce MP, released a consultation paper entitled *Corporate and Financial Services Regulation Review*. The consultation paper canvasses a possible extension to the business judgment rule which would allow a general protection for directors, excusing them from liability under the Corporations Act provided they act:

- in a bona fide manner;
- within the scope of the corporation's business;
- reasonably and incidentally to the corporation's business; and

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4 *Corporations Act 2001*, ss. 180(2).

5 Freehills Lawyers, *Submission 38*, p. 5.

- for the corporation's benefit.[6]

Impact of the current legislative framework

4.11 One of the more significant items of contention before the committee was the impact which the current directors' duties have on corporate philanthropy and corporate responsibility. Various interpretations of what the existing legal framework allows have been put forward, and these can be classified into four groups, which the committee will describe as follows:

- the *directors' restrictive interpretation*, under which directors claim that they are unable to undertake activities based on corporate responsibility, because such activities may not be directly 'in the best interests of the corporation';
- the *shareholders' restrictive interpretation*, which objects to corporations providing philanthropic funds or acting with deliberate corporate responsibility, because those funds could be invested in wealth generation (and thus returns to the shareholders);
- the *short term interests interpretation*, which allows that investment in corporate responsibility may be appropriate, but only if it can be justified on the basis of annual return on investment (competing with other possible investments); and
- the *enlightened self-interest interpretation*, which holds that careful and appropriate corporate responsibility is almost always in the interests of the corporation, and thus falls well within the behaviours permitted to directors under current duties.

Directors' restrictive interpretation

4.12 The 'directors' restrictive interpretation' begins with a fairly narrow view of what a company is, and applies to this a very narrow view of what the directors' duties allow. For proponents of this view, a corporation is an entity which exists purely for the purpose of profit generation, by any lawful means. A corporation is not a participant in the community, and has no obligations to the community which sustains it except those prescribed by law (and in particular by contract law). Consequently, any 'corporate responsibility' undertaken by these directors will either be incidental to profit generation, or incidental to the discharge of other legal obligations.

4.13 The Chamber of Commerce and Industry of Western Australia described this perspective (without endorsing it) in the following terms:

> Under this shareholder-oriented model … no more is expected of businesses than that they obey the rules as they go about their core function

6 Parliamentary Secretary to the Treasurer, the Hon Mr Chris Pearce MP, *Corporate and Financial Services Regulation Review*, April 2006, p. 32.

> of generating profits. […] Positive advocates of the shareholder-oriented firm assert that maximising profit within a framework of laws is both the most ethically appropriate behaviour of business managers and the most socially desirable, because it leads to the best economic and social outcomes. This view has been stated by Milton Friedman, who argued 40 years ago that "…there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits to long as it stays within the rules of the game.
>
> The negative view of shareholder orientation presumes that corporate ethics is an oxymoron. In this view nothing better than greed can be expected of business operators and pursuit of owners' interests will be at the expense of the wider community, so a system of laws and regulations is necessary to force corporations to behave according to the community interest. An oft-quoted observation from the 18th century British jurist Edward Thurlow sums up this view summarising the hopelessness of expecting unselfish behaviour from business: "Did you ever expect a corporation to have a conscience, when it has no soul to be damned, and no body to be kicked?[7]

4.14 An example of this approach in practice, commonly referred to in evidence before the committee, was the decision of the James Hardie Group to restructure its corporate affairs so as to quarantine itself from liability for the health effects of its asbestos products. Such a decision was clearly in the interests of the shareholders at the time it was made (as it was calculated to assist them in avoiding significant financial liability) but it was clearly contrary to the interests of external stakeholders: employees and others affected by asbestos-related diseases as a result of their contact with James Hardie products. James Hardie Chairwoman, Ms Meredith Hellicar has stated publicly that the company had taken a 'hard nosed' approach to its responsibilities at least in part because of concern by the Directors that the law *required* them to circumvent liability if this was in the clear interests of the company. In the *Australian Financial Review*, Ms Hellicar stated:

> I think protection [for Directors seeking to act in the interests of stakeholders other than shareholders] would be beneficial because there is no doubt that the threat of a shareholder suit – even if we get majority shareholder support – a minority shareholder can still say, we don't agree, so some protection would help … it certainly might make us feel more comfortable.[8]

4.15 James Hardie did not make a submission to the inquiry, and hence were not called as witnesses. However during this inquiry the company's actions in restructuring to avoid liability became the key example of corporations advancing the interests of shareholders at all costs. The company's activities were discussed on a number of occasions. One significant analysis was given by Professor Nowak of the

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7 Chamber of Commerce and Industry of Western Australia, *Submission 92*, p. 5.

8 Fiona Buffini, 'Calls to Protect Corporate Conscience', Australian Financial Review, 23 November 2005, p. 4.

Governance and Corporate Social Responsibility Research Unit at the Curtin Business School who stated:

> If you take Meredith Hellicar's argument that one of the things that was in the minds of the directors was that they needed to do this restructure to protect shareholder value as they saw it at that time, then I think that gave them a rather lopsided view of the way in which they should be making their decision. I would argue that that lopsided view needs to be corrected.[9]

4.16 Another example raised during the inquiry was an issue regarding Tasmanian vegetable growers who have been dramatically affected by a series of 'ad hoc, unilateral' decisions by companies with major purchasing power, to purchase their produce from overseas.[10] The growers cast the issue in terms of corporate responsibility, as follows:

> The 'boom and bust' cycles attached to much of Australia's commodity based industries, such as vegetable processing, means that decision-making based on short term cost competitiveness is not necessarily in the long term interests of the industry sector, nor the regional communities that support them. This is because the ultimate cost competitiveness of these sectors is likely to be based on a range of pertinent long-term issues, beyond immediate cost advantages: climate, soil, diversity in product line and innovation in business models. This is an issue of sustainability, not necessarily taken into account when decisions are made on short-term, cost competitiveness.[11]

4.17 The committee agrees that the decisions of the companies involved in this example were regrettable. They appear to be driven by a restrictive interpretation of directors' duties and with a sole view to maximising short-term profits with insufficient regard for the longer-term implications for both the company or the surrounding communities. The companies have suffered reputational damage as a result of their decisions, which have clearly had a major impact on growers and their communities. The companies have also neglected the concerns of local communities, which is both its customer base, and also a potential future supplier of produce.

Committee view

4.18 The committee considers that directors who take this 'restrictive interpretation' approach to the current law are misinterpreting the law. The current directors' duties were intended to provide protection for shareholders, not to create a safe harbour for corporate irresponsibility. However, the committee also came to the view that this interpretation is relatively uncommon in corporate Australia. Most directors appear

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9 Professor Margaret Nowak, Research Director, Corporate Governance and Social Responsibility Research Unit, Curtin Business School, Curtin University of Technology, *Committee Hansard*, 20 February 2006, p. 32.

10 Tasmanian Farmers and Graziers' Fair Dinkum Food Campaign, *Submission 123*, p. 2.

11 Tasmanian Farmers and Graziers' Fair Dinkum Food Campaign, *Submission 123*, p. 3.

ready to accept that the current directors' duties allow them some leeway for corporate responsibility and philanthropy. The question for them is under what circumstances they should put corporate responsibility ahead of immediate profit generation. The answer for each company will depend on which of the final three interpretations discussed in this section are adopted, and on the competitive pressures, strategic position and community expectations of each individual company.

Shareholders' restrictive interpretation

4.19 The shareholders' restrictive interpretation reaches a similar position to the directors' restrictive interpretation, but via a different route. Proponents of this position are usually shareholders or shareholder advocates. Their view is that money invested in or generated by a company is in fact the property of the shareholders. Consequently, instead of the company investing in corporate responsibility or distributing corporate philanthropy, the company should distribute its funds to shareholders, and allow *them* to choose whether to reinvest the money, use it for consumption, or apply it to philanthropic causes. For the proponents of this view, then, any director who distributes corporate philanthropy or who deliberately chooses corporate responsibility over immediate profit, is acting outside the requirements of directors' duties.

4.20 The submission from Beerworth & Partners discussed this position as follows:

> Many shareholders to whom I speak are suspicious of corporate philanthropy. Many take the strong view that, rather than play the corporate Medici with funds that really belong to the shareholders, philanthropically minded Chairmen and CEOs should distribute them as dividends so that each shareholder can decide if she wishes to make the relevant donation.[12]
>
> I have noticed at a number of AGMs that some shareholders protest strongly against political or even significant charitable donations. The Directors may have not only acted in what they regarded as good faith, in the best interests of the corporation and for what they regarded as a proper purpose, but different minds have different views on these subjects. I am not at all confident that the extent under case law to which directors and officers may take into account stakeholder interests other than of shareholders is clear or easily discoverable.[13]

4.21 The committee notes that it remains open to corporations and an option for resolving any dilemma directors may feel in their particular circumstances, to put the Board policy to a shareholder vote (for example on philanthropic spending).

12 Beerworth & Partners, *Submission 82*, p. 3.

13 Beerworth & Partners, *Submission 82*, p. 5.

Committee view

4.22 In the committee's view, this interpretation is supported by a relatively small group of shareholders. Most shareholders are likely to understand that investment in corporate responsibility is likely to result in both short term and long term gains for the company, based on one of the two interpretations considered below.

4.23 In addition, the committee observed the substantial and growing group of investors who invest in 'ethical investment' structures, taking a deliberate decision to invest their money in companies with an appropriate ethical profile. These investors not only agree that directors should pursue corporate responsibility, they demand it as a precondition for their investment.

Short term interests interpretation

4.24 Directors who hold this interpretation have no particular objection to investing in corporate responsibility, but such investments must meet the same rigorous requirements as purely financial investments. Various means can be used to measure the performance of investments, but 'return-on-investment' is perhaps the most common.

4.25 Directors following this interpretation are usually prepared to consider responsible investments, but only if they can meet the required return-on-investment. So an exercise in corporate philanthropy will be considered in terms of how much goodwill (and, consequently, what increase in market share or sales) will be the result. It will *not* be measured in terms of how many underprivileged children are fed, or how many young students get scholarships, or how many youth football teams get jerseys. An investment in energy efficiency will be measured in terms of cost savings from the energy bill, not in terms of the tonnes of greenhouse gas emissions saved. An investment in workplace safety will be measured in terms of reductions in insurance premiums, not in terms of worker injuries saved.

4.26 An example of this form of interpretation can be found in the submission of the BT Governance Advisory Service (BTGAS), which stated:

> On energy efficiency, research repeatedly shows capital spending on energy efficiency, such as whole-building upgrades, are sound financial investments. A study conducted in the US assessed the financial risk and return from fourteen whole-building energy efficiency upgrade projects. The internal rate of return of the investment was calculated using a ten year project lifetime and the investment risk was measured as the variability in the expected investment return — the risk that it would produce more or less than the expected return on investment. The average return was more than 20%.[14]

14 BT Governance Advisory Service, *Submission 19*, p. 7.

Committee view

4.27 The committee is of the view that directors should not be constrained only to activities which are profitable or capable of tangible measurement. On the other hand, it is clear that there are still vast improvements to be made in corporate responsibility in areas which *do* generate profits. Australian companies, by pursuing increased water and energy efficiency, can decrease waste and decrease costs (at the same time reducing the load on essential social infrastructure). By increasing the availability of paid maternity leave, they can increase their profitability by continuing to access the talents of women who return to the workforce after having children. By contributing to scholarships, for instance, the Australian mining sector has sought to establish a steady stream of talented graduates who will ensure its continuing profitability in years to come.

4.28 The committee also notes a practical difficulty with this interpretation. In evidence Treasury officials noted that while the costs of undertaking corporate responsibility are reasonably quantifiable, the benefits, which are often intangibles such as improved reputation, are difficult to measure. This may reduce the likelihood of corporate responsibility activities being adopted because their benefits are underestimated. This point is discussed further in chapter 8.

4.29 Almost any Australian company could find ways to increase its profitability by looking for ways to increase its corporate responsibility. While the committee does not consider that directors' duties are *limited* to corporate responsibility which turns a short term profit, the committee is strongly of the view that Australian companies should at least seek to undertake those investments in corporate responsibility which generate profit and competitive advantage (while at the same time generating a wider community benefit).

'Shareholders first' interpretation

4.30 A further interpretation may be discerned, though it is perhaps a variation on both the shareholders' restrictive interpretation and the short term interests interpretation. Under this interpretation, there is no particular objection to directors considering the interests of stakeholders other than shareholders, but the interests of shareholders must be the clear priority. Dr Forsyth and his colleagues from the Department of Business Law and Taxation at Monash University appear to take this interpretation:

> The basic legal position is quite straightforward: the duty of directors to act in good faith and in the best interests of the company … requires directors to treat *shareholders'* interests as paramount. The interests of employees, or other stakeholders, *can* be considered in performing these duties – but only where this would be in the company's (ie the shareholders') interests.[15]

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15 Department of Business Law and Taxation, Monash University, *Submission 39*, p. 17.

Committee view

4.31 The committee considers that this interpretation, like the shareholders' restrictive interpretation and the short term interests interpretation, is too constrained. In addition, as noted above, the committee does not agree that acting in the best interests of the *corporation* and acting in the best interests of the *shareholders* inevitably amounts to the same thing. Consequently, the committee is not attracted to this interpretation.

Enlightened self-interest interpretation

4.32 The enlightened self-interest interpretation of directors' duties acknowledges that investments in corporate responsibility and corporate philanthropy can contribute to the long term viability of a company even where they do not generate immediate profit. Under this interpretation directors may consider and act upon the legitimate interests of stakeholders to the extent that these interests are relevant to the corporation. Chapter 3 of this report included discussion of the factors that drive corporate responsibility, and some of these factors in particular clearly show how corporate responsibility can be in the interests of companies (and therefore well within the bounds of directors' duties). These driving factors demonstrate how forward thinking directors, motivated by an enlightened approach to the company's self-interest, can undertake activities which contribute to social wellbeing and environmental protection, and which are clearly in the best interests of the company from a commercial perspective. The key driving factors to note are:

4.33 **Community license to operate**: The concept of a 'community' or 'social' 'license to operate' by companies was raised in several submissions. By effectively engaging with the communities in which they operate, companies gain tacit permission to continue in operation.

4.34 **Reputational factors**: Enlightened self-interest takes into account reputational factors well beyond mere community license to operate. Appropriate corporate responsibility can lead to positive corporate reputations which can in themselves have value for the company (particularly in terms of intangibles such as goodwill).

4.35 **Avoidance of regulation**: Corporate responsibility serves enlightened self-interest because by taking voluntary action to improve corporate performance, corporations may forestall regulatory measures to control their conduct.

4.36 **Attraction and retention of staff:** A number of submitters and witnesses stated that an enlightened approach to corporate responsibility assisted them in their efforts to recruit and retain high quality staff, particularly in the currently-tight skilled labour market.

4.37 **Attraction of investment from ethical investment funds:** The growth of ethical investment funds has been a key feature of the corporate responsibility environment in recent years, both in Australia and overseas. While these funds currently administer a relatively small proportion of the market, evidence before the committee was that their size is growing.[16]

Committee view

4.38 The committee has considered the various interpretations of directors' duties given above. In the committee's view, the restrictive interpretations overstate the impact of sections 180 and 181 of the *Corporations Act 2001*. While some directors have used these interpretations to defend irresponsible activities, many other directors have led their companies towards increased corporate responsibility, without facing the shareholder revolts imagined by those holding a restrictive view.

4.39 The committee considers that the most appropriate perspective for directors to take is that of enlightened self-interest. Corporations and their directors should act in a socially and environmentally responsible manner at least in part because such conduct is likely to lead to the long term growth of their enterprise.

Options for legislative change

4.40 While the committee has stated above that in its view there is nothing in the current legislation to inhibit directors from taking account of stakeholders other than shareholders, the committee is still open to consider the various proposals for reform which were given in submissions and evidence. There were four common proposals put forward. Those were as follows:

- a *directive* view that the legislation in its current form is far too weak and should be amended in order to make corporate responsibility compulsory;
- a *permissive* view that the legislation in its current form probably allows for corporate responsibility but should be clarified in order to provide directors with additional protection;
- the *status quo* view that the legislation in its current form is sufficient to allow enlightened self-interest to operate, and need not be changed; and
- the *whole-of-law* view suggesting that the Corporations Act should not be looked at in isolation, as corporations are regulated by many other pieces of state and Commonwealth legislation that cover economic, social and environmental matters.

4.41 In addition, the committee noted the interesting proposals that the Corporations Act include an 'ethical judgment rule' or an additional replaceable rule. Each of these will be dealt with in turn.

16 Ms Louise O'Halloran, Ethical Investment Association, *Committee Hansard,* 23 November 2006, p. 34.

The directive view

4.42 A number of submissions argued that the Corporations Act should direct corporations, and in particular directors of corporations, and to take account of the interest of stakeholders other than shareholders. For example, the Department of Business Law and Taxation at Monash University stated:

> The approach of mandating directors to take into account social, environmental and other stakeholder interests is not a radical step, as progressive corporations are already prepared to promote themselves as socially responsible in accordance with various voluntary CSR strategies. However, the absence of mandatory decision making criteria on these matters at the corporate level often allows social and environmental considerations to either escape notice, or be deliberately ignored. Arguments that shareholder interests are threatened by new obligations of this kind may be largely illusory. The growth of institutional shareholders and the likelihood that most shareholders will have diverse holdings across many corporations and industry sectors (either directly or through superannuation funds), means that there is now a much greater commonality of interest between shareholders and the broader community.[17]

4.43 A number of these submissions took as a model proposed British legislation entitled the Company Law Reform Bill 2005. This Bill is an extensive reform of virtually all aspects of corporate law in the United Kingdom. Part 10 Chapter 2 of the Bill sets out the proposed duties of Directors. Clause 156 sets out the duties relevant to this inquiry, and represents the UK government's attempt to balance duties to shareholders with duties to other stakeholders. The provision states:

> **156 Duty to promote the success of the company**
>
> (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole.
>
> (2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, his duty is to act in the way he considers, in good faith, would be most likely to achieve those purposes.
>
> (3) In fulfilling the duty imposed by this section a director must (so far as reasonably practicable) have regard to—
>
> (a) the likely consequences of any decision in the long term,
>
> (b) the interests of the company's employees,
>
> (c) the need to foster the company's business relationships with suppliers, customers and others,

17 Department of Business Law and Taxation, Monash University, *Submission 39*, p. 28.

(d) the impact of the company's operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

(f) the need to act fairly as between members of the company.[18]

4.44 Several submissions noted that this bill represents an attempt to codify and make compulsory the 'enlightened self interest' approach discussed above. This approach was endorsed by the Australian Network of Environmental Defenders' Offices:

> It should be noted that the language of the Bill is prescriptive not merely permissive, and in effect, it would amend directors' duties to enable an enlightened shareholder value approach to decision-making. The introduction of similar legislation in Australia should be actively considered as it would address several of the concerns raised in this submission regarding the inadequate manner in which organisational decision-makers currently take into account non-shareholder interests.[19]

4.45 Some submissions however, felt that merely endorsing enlightened self interest did not go far enough. The Australian Conservation Foundation stated:

> The difficulty with this bill is that it treats the interests of corporate constituencies as means to the end of shareholder profits, rather than legitimate interests in themselves. In effect, the bill provides no greater consideration for communities or the environment, and no safe harbour for directors, beyond that contained in a simple unadorned statement of shareholder profit maximisation.[20]

Committee view

4.46 The committee does not support the British approach, which appears to introduce great uncertainty into the legal expression of directors' duties. For instance, there is no way to forecast those circumstances under which a court might decide that a company's purposes 'consisted of or included purposes other than the benefit of its members.' And what might a court determine those purposes to be? Until such a determination was made with respect to a particular company, directors may not even be sufficiently equipped with basic knowledge about those to whom they owed a duty. Subclause (3) requires directors to have regard to a menu of non-shareholder interests, but gives no guidance as to what form this 'regard' should take, and therefore gives no guidance to directors on what they must do in order to comply.

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18 Company Law Reform Bill 2005 (UK), cl.156.

19 Australian Network of Environmental Defenders' Offices, *Submission 48*, p. 11.

20 Australian Conservation Foundation, *Submission 21*, p. 17.

4.47 As a matter of general principle, the committee considers that a law which imposes duties should give those upon whom the duty is imposed clear guidance as to whom the duty is owed, and how it is to be discharged. A law which does not is bad law, and at the very least magnifies the uncertainties faced by directors.

4.48 Furthermore, it has been noted in relation to many different legislative schemes that directive legislation breeds a culture of compliance. Within corporations, once legislation is imposed, it is likely that compliance managers will take the lead and that the corporation's response will be driven by a those compliance managers' desire to meet the requirements of the legislation. Such activity is unlikely to satisfy those who advocate on behalf of social or environmental causes, leading to inevitable calls for legislation to become more stringent, prosecutors to become more aggressive, and penalties to become more severe. Chartered Secretaries Australia (CSA), for instance, stated:

> CSA also believes that performance pressures will encourage companies to have regard for the interests of stakeholders other than shareholders and that this does not need to be legislated. Indeed, if it were to be mandated, having regard for stakeholder interests other than shareholders would likely become a compliance-driven, box-ticking exercise, rather than an innovative, value-creating opportunity to improve performance.[21]

4.49 For the reasons expressed above, the committee is opposed to directive provisions in the Corporations Act.

A permissive provision

4.50 One approach in use overseas, particularly in the United States, is a permissive provision to make it clear that directors are entitled to make decisions which reflect the interests of stakeholders other than shareholders. The argument in this case, essentially, is that directors (following the directors restrictive interpretation) have been unnecessarily timid in approaching corporate responsibility, concerned that where efforts to improve corporate responsibility result in diminished short-term performance, there will be a backlash from shareholders or from the stock market. Mr Kerr set out one view of the United States experience:

> Some commentators feel that U.S. constituency statutes are “red herrings” and have done little to advance the interests of non-shareholders under U.S. corporate law. While these statutes represent a statutory variation of the directors' duty to act in the best interests of the company, the laws do not oblige directors to act in a socially responsible fashion. Of the 32 constituency statutes in place, all but one are permissive in nature. In other words, the directors may take the interests of non-shareholders into account, but are not obliged to do so. As a consequence, constituency groups do not have enforceable rights should their interests be ignored.[22]

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21 Chartered Secretaries Australia, *Submission 28*, p. 10.

22 Mr Michael Kerr, *Submission 7*, pp 114–115.

4.51 This approach had limited support from witnesses and submitters before this inquiry. Some, such as the Department of Business Law and Taxation from Monash University, were prepared to support a permissive provision as a less preferred option, but most stakeholders, from both sides of the debate, saw it as a poor alternative.

4.52 Some submitters saw a permissive provision as an easy way out, unlikely to result in increased corporate responsibility. The Public Interest Law Clearing House stated:

> Such an approach [a permissive provision] is, however, likely to be deficient for two key reasons.
>
> First, experience suggests that compliance with voluntary or permissive legislation or codes of conduct is likely to be limited, particularly where compliance may occasion some form of financial detriment (regardless of social or environmental outcomes) and among reticent corporations. Permissive legislation tends to work best for already well-intentioned actors.
>
> Second, where a director may be permitted, but is not required, to consider the interests of a stakeholder other than a shareholder, it is unclear whether, how and by whom such consideration could be assured or enforced.[23]

4.53 Other submitters were concerned that a permissive provision may end up as a *de facto* mandatory provision. Mr Münchenberg from the Business Council of Australia noted in evidence that:

> A large part of our concern is that … [courts] assume, perhaps from naivety, that the parliament does not do things without good reason. They infer what those reasons might be. […]They then construct interpretation around what that may mean. The thing that worries us is that we do not know what bizarre circumstances may one day arise about which a court has to take regard to this provision. Were we solving a particular key problem we may be prepared to take the risk, but, if there is no major problem, why take the risk?[24]

4.54 Mr Münchenberg then agreed with Senator Brandis' proposition that 'there are some Federal Court judges who … say may means ought'.[25]

Committee view

4.55 The committee is concerned that such a permissive provision may in effect amount to shifting the goalposts rather than dealing with the problem. Directors who currently feel constrained by the Corporations Act may, after the enactment of such a

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23 Public Interest Law Clearing House (Homeless Person's Legal Clinic), *Submission 4*, p. 23, references omitted.

24 Mr Steven Münchenberg, Deputy Chief Executive, Business Council of Australia, *Committee Hansard*, 23 February 2006, pp 100–101.

25 Senator George Brandis, *Committee Hansard*, 23 February 2006, p. 101.

provision, find themselves constrained instead by whatever definition of corporate responsibility is built into the Act. If a history had emerged of court judgments taking a narrow view of directors' duties, interpreting the law in such a way as to suggest that corporate responsibility did involve risk to directors, then the committee would consider a permissive provision. In the current inquiry, no submitter has been able to point to court judgments which suggested a judicial misinterpretation of current provisions. Under such circumstances, and given the clear lack of support from all parties, a permissive provision appears to be unjustified.

Arguments favouring the status quo

4.56 A substantial number of submissions argued that the current legislative scheme is not the problem: that it is sufficiently open to allow companies to pursue a strategy of corporate responsibility, and that many corporations are actively doing so. The Group of 100, for instance, argued that:

> ...mandating change is unnecessary in view of the current Corporations Law and other requirements. In many of these areas, as evidenced in the Business Council of Australia findings, the imperative is to remove regulatory duplication and contradictions rather than to impose another layer of requirements which may inhibit progressive behaviour on the part of companies and directors. The best encouragement for entities is to create an environment in which experimentation with reporting in this evolving area is able to flourish. In a competitive environment the priorities and reporting of leading companies will induce improved reporting by other companies in response to changes in community expectations. This is unlikely to occur under a mandatory regime.[26]

4.57 ASIC expressed the view that to change the law in relation to directors' duties would create problems for ASIC in effectively performing its role as the enforcement regulator:

> ...as an enforcement regulator on the one hand and a disclosure regulator on the hand we can see great problems in opening up very well settled law as to what the duties of directors are. If it were felt absolutely necessary by the government—and this is a government decision—to have some change to the system, we would prefer a tightly focused disclosure solution rather than opening up the whole question of directors' duties. The upset to the business of actually changing the law would be too great: 'What are we supposed to do? Who are these stakeholders? How to we rank the priority of one stakeholder against the other?' There would be all those questions. We see problems there. With our enforcement hats on, we see that if we are not careful that might build areas into which directors who had done something wrong could go and sit and say, 'Actually, the reason we did this was because of these new stakeholder rules.'[27]

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26 Group of 100, *Submission 27*, p. 2.

27 Mr Jeremy Cooper, Deputy Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 29 March 2006, pp 12–13.

Committee view

4.58 The committee is of the view that no compelling case for change has been presented during this inquiry. Directors' duties as they currently stand have a focus on increasing shareholder value. This is important, because the provision is first and foremost intended to protect those investors who trust company directors with their savings and other investment funds. Directors' duties enable such investors to have some confidence that their funds will be used to in order to increase the income and value of the company they part-own.

4.59 In many cases, it will be clear that corporate responsibility enhances shareholder value. At the very least, it is clear that rampant corporate irresponsibility certainly decreases shareholder value. Public allegations that the James Hardie Group had demonstrated corporate irresponsibility had dramatic and public consequences for the company over the past year. The more recent alleged irresponsibility of AWB Ltd has led to the resignation of its managing director and the commencement of a commission of inquiry under the Royal Commissions Act. Progressive, innovative directors, in seeking to add value for their shareholders, will engage with and take account of the interests of stakeholders other than shareholders.

Other legislation

4.60 Term of reference (d) for this inquiry specifically asks the committee to have regard to obligations that exist in laws other than Corporations Act. A number of submissions to the inquiry made the point that modern corporations are in fact bound by any number of statutes and regulations, arising from Commonwealth, state and territory laws. Environmental law, in particular, has been the scene of much activity in recent years. Simply in order to stay in business, corporations are required by various laws to take account of their environmental and social impacts. For instance, they are required to seek environmental approval before proceeding with certain projects, they are held to account for their pollution, and they are required to meet guidelines of safety for communities and for the workforce. In evidence, officers from Chartered Secretaries Australia stated:

> It is our view that a legislative and regulatory framework relating to the individual components of corporate responsibility is already in place. This body of existing federal and state law covers the environment, financial services, human rights, equal opportunity, industrial relations and occupational health and safety et cetera. Much of this legislation requires directors and other officers to take account of interests other than shareholders'.[28]

4.61 Several submitters recognised the legitimate role for governments to regulate in certain areas of corporate performance. For instance GlaxoSmithKline stated:

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28 Mr Tim Sheehy, Chief Executive, Chartered Secretaries Australia, *Committee Hansard*, 23 November 2005, p. 41.

> Few would seriously question the role of government in regulating some aspects of business behaviour. Competition and consumer laws are essential to combat unscrupulous conduct and protect more vulnerable members of the community. Securities and investment laws are necessary to maintain confidence in a functioning business sector. Workplace relations and occupational health and safety laws are vital to address imbalances of power between employees and their employers. And environmental regulations have proven an effective mechanism for combating market externalities.[29]

Committee view

4.62 In the committee's view, this network of legislation shows that the social and environmental performance of corporations is already regulated in a number of areas. The existence of such substantial and specific legislation provides further argument against the need for any amendment of Corporations Act.

An ethical judgment rule

4.63 The St James Ethics Centre proposed an 'ethical judgment rule' which could be included in the Corporations Act and which would have similar status to the business judgment rule currently used to assess the performance of directors. The proposal was put in this form:

> we would recommend an amendment to the Corporations Act, similar to the provisions relating to the 'business judgement rule', allowing company directors to make decisions based on *bona fide* ethical considerations (including but not limited to the interests of stakeholders other than shareholders) – and protecting them from liability for doing so when a reasonable person would judge those considerations to be well founded. This protection should be afforded in all cases – including when the decision may have some detrimental effect on the financial interests of the company as a whole, its shareholders or some group of them. As such, directors relying on the 'ethical judgement rule' as a defence, would be required to produce documents demonstrating the quality of the reasoning employed in reaching their decision. Courts would only be entitled to review the substance of any decision if the quality of the decision-making process was first found to be inadequate.[30]

4.64 The committee does not support this proposal. However it was one of the most innovative and interesting proposals for legislative change put forward during this inquiry. Consequently, the committee wishes to be clear about its reasons for not supporting such a role.

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29 GlaxoSmithKline, *Submission 49*, p. 4.

30 St James Ethics Centre, *Submission 50*, p. 4.

4.65 First and foremost, as noted above, the need for an amendment to the Corporations Act has yet to be shown. Before considering the value of amendment such as an ethical judgment rule, the committee would need to be convinced that *any* amendment to the Act was required. In the committee's view, the Act in its current form is sufficient.

4.66 Second, the committee is concerned that an ethical judgment rule, rather than enabling decision-making based on court responsibility, would become a defence against allegations that the business judgment rule had been broached. Directors accused of failing to exercise proper business judgment might instead point to the ethical judgment rule as a justification for their actions. The committee notes the view put in evidence by Dr Longstaff that this objection is not insurmountable:

> It is possible to develop principles. I would be happy to rely on the fact that, if somebody was just trying it on and saying, 'We made a hopeless decision but we are going to pretend it was an ethical decision,' they would be exposed. One of the things you would want to do is ensure that they were not retrospectively trying to justify it. If such a provision was introduced into law to afford this kind of protection, it would have to be for decisions made at the time, where you could see the process of decision making going on as the decision was being made, and not something which is introduced after the event.[31]

4.67 The committee notes that there is an argument that with the various corporate governance rules that already apply to corporations, the business judgement rule already requires (implicitly at least) an ethical judgement.

4.68 However, ultimately, the committee remains concerned that in an appropriate court case, even as a defence of last resort, the ethical judgment would be called upon by directors who had failed in their duties.

A replaceable rule

4.69 The *Corporations Act 2001* contains a series of provisions (listed in tabular form in section 141) which are known as *replaceable rules*. Under subsection 135(2) of the Act, a replaceable rule has effect on a company as though it were part of the company's constitution. However the rule 'can be displaced or modified by a company's constitution.'[32] In other words, the replaceable rule provides a default provision, but any company may, by resolution, opt out of the rule. CSA initially proposed a replaceable rule to cover corporate responsibility:

> A clause can be included in a company's constitution permitting directors to take account of the interests of stakeholders other than shareholders, for example, 'for any purpose that the board sees fit'. CSA believes there is

31 Dr Simon Longstaff, Executive Director, St James Ethics Centre, *Committee Hansard*, 23 November 2005, pp 19–20.

32 *Corporations Act 2001*, ss. 135(2).

> merit in the *Corporations Act* including such a provision as a replaceable rule. Shareholders would decide whether they wanted it, or a revised version of it, as an object in the constitution.[33]

4.70 This idea has some initial appeal, because it would make a subtle but profound change to the dynamics of decision making on corporate responsibility. Corporate responsibility proponents would no longer be required to try to convince companies to take greater account of stakeholders other than shareholders; rather, any corporation which so wished could make a deliberate decision to exclude such considerations. The reputational implications of doing so may, of course, be significant.

4.71 Perhaps for this reason CSA moved, in oral evidence, towards recanting its support for a replaceable rule:

> I think it is important for the record that technically we are not calling for this. I think that is an important point to make. We definitely have included it in our submission—and we chose our words carefully—as a notion that has some merit. But we are firmly of the view that the Corporations Act is adequate. We are not calling for an enabling section or anything like that. In honesty, I guess that if we were pressed then this would be something that we think has merit […]For the record, we are not calling for it.[34]

4.72 Other witnesses expressed reservations about a replaceable rule. A witness from the Australian Institute of Company Directors stated:

> I would say to somebody who came to me, 'Are you in fact, by another route, trying to limit your directors rather than making them more free?' At the end of the day, I think that is what that does.[35]

4.73 Mr Honan from the Group of 100 brought consideration of a replaceable rule back to the concept of enlightened self-interest:

> I do not believe that is necessary, because the directors need to act in the best interests of the company and, if they ignore the interests of the community or other stakeholders, they are not acting in the best interests of the company.[36]

4.74 Professor Redmond raised perhaps the most cogent argument against a replaceable rule when he noted that such a rule would effectively give shareholders the right to withdraw from directors the capacity to consider stakeholders other than

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33 Chartered Secretaries Australia, *Submission 28*, p. 11.

34 Mr Tim Sheehy, Chief Executive, Chartered Secretaries Australia, *Committee Hansard*, 23 November 2005, p. 44.

35 Ms Kathleen Farrell, Member, Law Committee, Australian Institute of Company Directors, *Committee Hansard*, 23 November 2005, p.86.

36 Mr Thomas Honan, National President, Group of 100, *Committee Hansard* , 24 February 2006, p. 4.

shareholders. Where a company's shareholders have removed the replaceable rule, it seems to follow that directors would consider themselves under instructions to refrain from considering the interests of other stakeholders. Professor Redmond stated:

> This is not a matter of shareholder autonomy; this is a matter in which I think you are legitimately protecting directors against shareholders to a certain extent. You are enabling them to give effect to either ethical considerations or their own sense of where the company's long-term benefit lies, against all the market pressures of short-term impacts. I think there is a public interest in granting that licence and doing it in a way that does not allow shareholders the autonomy of withdrawing it.[37]

Committee view

4.75 The committee remains of the view that a replaceable rule is an interesting approach to the issue of corporate responsibility. In view of the Chartered Secretaries' clarification of their position, and the rebuttals expressed by other witnesses, the committee does not recommend that a replaceable rule be implemented.

Conclusions

4.76 The committee considers that an interpretation of the current legislation based on enlightened self-interest is the best way forward for Australian corporations. There is nothing in the current legislation which genuinely constrains directors who wish to contribute to the long term development of their corporations by taking account of the interests of stakeholders other than shareholders. An effective director will realise that the wellbeing of the corporation comes from strategic interaction with outside stakeholders in order to attract the advantages described earlier in this chapter.

4.77 The committee considers that more corporations, and more directors, should focus their attention on stakeholder engagement and corporate responsibility. However it is clear from this chapter that any hesitation on the part of corporate Australia does not arise from legal constraints found in the Corporations Act. As the problem is not legislative in nature, the solution is unlikely to be legislative in nature. Elsewhere in this report, the committee gives long consideration to other, non-legislative ways in which Government might encourage greater corporate responsibility. However, the conclusion of this chapter is that amendment to the Corporations Act, and in particular to the provisions setting out directors' duties, is not required.

Recommendation 1

4.78 The committee finds that the *Corporations Act 2001* permits directors to have regard for the interests of stakeholders other than shareholders, and recommends that amendment to the directors' duties provisions within the Corporations Act is not required.

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37 Professor Paul Redmond, *Committee Hansard*, 9 March 2006, p. 47.

CHAPTER 5

INSTITUTIONAL INVESTORS

...the best strategy is for us to engage with companies over the long term in an effort to improve their social, environmental, governance and financial performance – to change the direction of the ship rather than jumping ship[1]

5.1 Large institutional investors are in an unusual position in the corporate responsibility debate. Notwithstanding the opportunity to participate in Annual General Meetings, most small investors are essentially passive, and have little capacity to influence the management of the companies in which they invest. They are simply too small, and control too little a shareholding, to have any such impact. Institutional investors, however, control vast sums of money, and have both the capacity and the occasion to exert direct and substantial influence over the operation of listed companies. This gives institutional investors the capacity to influence corporations' approaches to corporate responsibility including the management of non-financial risks.

5.2 This chapter explores the role of institutional investors in advancing corporate responsibility.

Characteristics of institutional investors

5.3 Before considering the role of institutional investors in corporate responsibility, it is appropriate to describe what the committee means by 'institutional investors' and to outline some of the characteristics of such investors, and how they differ from individual retail investors.

5.4 Institutional investors, broadly, are institutions through which investors collectively invest. Retail investors therefore invest in the institutional investors, who in turn invest in listed companies (or other investment products). This allows small investors to invest in a broad range of shares, and to have their investment actively managed, under circumstances where they may not have the time or expertise to do so themselves. Obvious examples of institutional investors include superannuation funds and managed funds.

5.5 For the purposes of this report, institutional investors have three important characteristics which set them apart from most other shareholders. First and foremost, they are large scale investors with massive funds at their disposal. Largely due to compulsory superannuation arrangements, Australia is the world's fourth biggest fund management market and the largest in the Asia Pacific. In Australia there is

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1 Sir Graeme Davies, Chairman, Universities Superannuation Scheme (UK), *0.618*, issue 5, January 2005.

$955 billion under management[2] with about $30 billion of new funds flowing in every year.[3] Consequently, institutional investors are able to exert considerable influence over a company's operation. In many cases, these large institutional investors may be able to influence the membership of boards, therefore having a direct and immediate impact on the decisions of directors.

5.6 The second important characteristic of institutional investors is that they are able to invest in the long term. Because of their size, and their ability to spread funds across a diverse range of investments, institutional investors are able to take a longer term position in companies. Mr Münchenberg from the Business Council of Australia put the proposition aptly and succinctly: 'If anyone has a long-term interest, it is surely the superannuation funds.'[4]

5.7 As a result, large institutional investors may not be constrained by the short-term investment market needs which, it has been suggested elsewhere in this report, force companies to sacrifice corporate responsibility in pursuit of immediate profit.

5.8 Finally, institutional investors generally invest as trustees (in the general, rather than the legally specific, sense of the word). They are investing other people's money. Consequently they have duties to *their* investors or members, which in some ways parallel directors' duties, and attract the same concerns as were discussed in chapter 4.

5.9 The rest of this chapter considers these features of institutional investors, and their impact on corporate responsibility. The chapter considers:

- the impact of longer term investing on institutional investors' perceptions of both risk and opportunity;
- the ways in which institutional investors can use their size and influence to promote corporate responsibility and better management of non-financial risks;
- the duties of institutional investors, and whether these inhibit a commitment to corporate responsibility;
- the extent to which institutional investors have been active in promoting corporate responsibility; and finally

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2 Australian Bureau of Statistics publication 5655.0, 'Managed Funds Australia, December 2005, http://www.abs.gov.au/AUSSTATS/abs@.nsf/ProductsbyCatalogue/4896C3F895880688CA2568A900139379?OpenDocument, accessed 13 June 2006.

3 Coghill, Black, Holmes, *Submission 71*, p. 3.

4 Mr Steven Münchenberg, Deputy Chief Executive, Business Council of Australia, *Committee Hansard*, 23 February 2006, p. 93.

- whether legislative changes are required in order to support further involvement in corporate responsibility by institutional investors.

Long term investment

5.10 As noted above, institutional investors are more likely than retail investors to consider longer term investments. The 2003 Department of the Environment and Heritage report *Corporate Sustainability – an Investor Perspective*, put it as follows:

> Long term investors such as superannuation and insurance funds are most exposed to social and environmental risks embedded in the companies in which they invest. The relative concentration of the Australian sharemarket and the widespread use of benchmark indices in investment means that as they grow, institutional investors increasingly become permanent owners of shares in companies. Sustainability considerations particularly benefit these long term investors.[5]

5.11 Of course, this does not mean that institutional investors do not take advantage of short term, speculative investments too. However most institutional investors have sufficient funds under management that they can do both; while many retail investors lack this luxury.

5.12 Longer term timeframes expose institutional investors to both long term opportunities, and long term risks.

Longer term opportunities

5.13 Given the longer timeframes of institutional investors, they can afford to support corporate strategies which may not yield immediate profits, but which give companies the basis for longer term sustainable profitability. It has been noted elsewhere in this report that many 'corporate responsibility projects' fall into this category.

5.14 A director seeking to satisfy market and shareholder demands for short term, short-sighted growth and profits will be unlikely to see any 'enlightened self interest' in long term, responsible projects which do not generate immediate profit. On the other hand, a director who is influenced by longer term institutional investors may be emboldened to operate the company in a socially and environmentally responsible manner, even if this means sacrificing short term profits. This will be even more the case if those institutional investors directly press for greater corporate responsibility, as discussed below.

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5 Department of the Environment and Heritage, *Corporate Sustainability – an Investor Perspective* (the 'Mays Report'), 2003, p. 18.

Longer term risks

5.15 One of the difficulties faced by social and environmental campaigners is that they are promoting dangers and concerns which are likely to be felt in the long term rather than the short term. Changes in air quality, for instance, are not likely to be particularly noticeable on a daily basis or even, in many cases, on a yearly basis. The ecological impact of a reduction in biodiversity, while very real, is also going to occur in imperceptible increments. From a social perspective, a slow decline in literacy or a slow rise in alcoholism or depression might operate in the same way.

5.16 For a short term investor, corporate strategies which sacrifice an immediate profit in the current quarter, for the sake of better air quality into the future, may well appear unattractive. If the desire is to realise a profit within days or weeks, and the change in air quality in that period of time is likely to be virtually nil, then the sacrifice will be too great.

5.17 For the longer term investor, however, slow changes in environmental and social conditions matter. While a short term investor only wants to know what a mining company will produce this month, and what the commodity price for its product is, the longer term investor wants to know whether the company is exploring for further resources, whether its land rehabilitation projects are sufficient that they will avoid regulatory penalties, and whether the company is adept at managing its relationship with its workforce, its local community and in many cases the Indigenous custodians of local lands.

5.18 The BT Governance Advisory Service (BTGAS) submission outlined this longer term approach to risk as follows:

> Long term investors expect organisational decision makers to have a regard for the interests of stakeholders other than shareowners when those stakeholder interests have the capacity to influence shareowners' interests. We believe that companies that manage their stakeholders' interests are managing their shareowners' interests, especially over the long-term. This arises from the fact that risks to companies arise not just from typical financial risks but also from regulatory, community and litigation risks.[6]

5.19 Long term risk is an even greater issue for the insurance industry, which by its very nature is involved in the management of long term economic risks. For these very reasons, the insurance industry has been among the most progressive in terms of identifying long term environmental and social risks, and supporting both investment and effort to avoid them. The Insurance Australia Group (IAG) gave an example of this process in its submission:

> IAG is now exploring … how our scale could best be utilised to influence and benefit the broader range of IAG's stakeholders. This requires understanding of long term shareholder value that can be derived from

6 BT Governance Advisory Service, *Submission 19*, p. 2.

> integrating such an approach into the short-term financial imperatives (such as costs).
>
> For example, IAG understands that its long term business will be impacted by human induced climate change, typified by an increase in the frequency and ferocity of weather events that will result in increased insurance claims and payouts. IAG is addressing how it might best leverage its scale with its supply chain to address the primary cause of climate change, greenhouse gas emissions. The use of IAG's scale could assist in leveraging outcomes that both increase awareness of the impacts of climate change and assist in reducing greenhouse gas emissions.[7]

Size of institutional investors

5.20 A simple reality of investment is that money talks. This has been institutionalised in the *Corporations Act 2001* in paragraph 250E(1)(b), which gives members one vote at meetings, for every share they hold. Those with more shares, have more votes. On a more daily basis, large institutional investors have the capacity to affect significantly the share price of companies in which they invest, because they can create significant demand for a particular share, or alternatively (by selling their own shares) can significantly increase supply into the market. Each of these can have an obvious effect on the share price.

5.21 The size of institutional investors, with their attendant market power, can be used to promote corporate responsibility in a number of ways. Two related issues will be discussed below: the inclusion of corporate responsibility factors in company research; and the subsequent demand for better reporting.

Corporate responsibility and research

5.22 In order to be successful, institutional investors invest a great deal of time and money conducting research into listed companies in which they have an interest. This research might lead them to purchase shares in companies where they do not hold shares; or to divest themselves of shares they currently hold. This capacity to conduct research, and to invest successfully based on that research, is in fact at the heart of the service which institutional investors provide to their clients.

5.23 In the past, company research was primarily a financial affair. The company's financial performance was analysed to determine its prospects for growth and profit into the future. Along with this, matters which are related to financial performance while not strictly financial, are taken into account. These include matters such as corporate governance, and the company's strategic position in its key markets.

5.24 In recent years, many institutional investors have begun conducting research into corporate responsibility factors, on the basis that a company's management of these has an impact on its longer term profitability; and also on the assumption that a

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7 Insurance Australia Group, *Submission 29*, p. 12.

company which can successfully manage its social and environmental impacts and risks, is also likely to manage its overall business successfully.

5.25 Obviously the 'ethical investment' sector has this form of research at its heart. For these investors, the environmental and social performance of a company may rule it out of an investment portfolio, regardless of its potential for economic success:

> The ones who are ahead of the game are the sustainable responsible investment analysts. They do look at between 100 and 200 extra issues of analysis when they value a company. So they will look at financial analysis but they will also look at all the issues—I would imagine that you are all aware of the particulars in the [Global Reporting Initiative (GRI)]. When you start comparing and contrasting performance against GRI indicators, you start to get a much broader picture of a company's capability.[8]

5.26 Evidence before the committee suggested, however, that even mainstream institutional investors, whose primary focus is well and truly on financial performance, are beginning to take note of environmental and social factors. This does not represent a rush of ethical concern, but rather a realisation that social and environmental risks and opportunities can be material to a company's future financial performance. In a recent UN report, investment giant ABN AMRO stated:

> Pricing 'non-financial risk' is difficult. It may be beyond our present valuation metrics to give it an exact quantifiable value. However, there are strong theoretical grounds for measuring these risks on a company-relative basis and this may help to value the risks of a company relative to its peers more accurately … Furthermore, understanding CSR gives a deeper understanding of the company and the business threats it faces. We believe these types of risks warrant closer examination by analysts and should lead to added value in investment decisions.[9]

5.27 By taking non-financial risk management into account when assessing investment prospects, institutional investors are able to provide a strong drive to 'enlightened self interest'. Corporations who wish to attract investment from institutional investors will find themselves judged – at least in part – on their social and environmental performance. Senior managers, who are renumerated partially in shares or derivates, will find that the value of their remuneration package is influenced by the market value of their company, which in turn depends partially upon their corporate responsibility.

5.28 Mr Brown from ANZ Bank illustrated this form of remuneration package, although his evidence was that corporate responsibility is not (currently) seen as an important driver of overall remuneration:

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8 Ms Louise O'Halloran, Executive Director, Ethical Investment Association, *Committee Hansard*, 23 November 2005, p. 34.

9 ABN AMRO Equities United Kingdom 'Pharmaceuticals and SRI' in United Nations Environment Programme Finance Initiative, *The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing – 11 Sector Studies*, 2004, p. 15.

All senior executives are now rewarded on an annual performance basis. From memory, certainly for the more senior executives in the bank, the weighting towards three-year performance objectives is now over half of their annual remuneration. More than half of my total remuneration for a year is based on two- or three-year out performance objectives for the organisation—the performance objective being share price. I would not call it long term; it is two or three years. … It is basically an option package which is set out on two- or three-year horizons. It will alter the further you go down in the organisation. It has made a difference.[10]

Reporting

5.29 This rush of research interest in corporations' environmental and social performance becomes a driver for better corporate responsibility. Experts conducting research on behalf of institutional investors argued before the committee that in many cases they lack adequate non-financial information from the companies and so find it difficult to make accurate judgments. For these researchers, 'greenwashed' social and environmental reports, with glossy covers showing photos of smiling children and healthy green tree frogs, will simply not be useful. Hard, verifiable data, comparable between companies (at least within sectors) is required. Market driven demand for this data is likely to be more effective than any government regulation in producing this information.

5.30 For instance, Professor Coghill and his colleagues stated:

A central issue for superannuation trustees is access to information to identify material issues and to incorporate such information into investment decision-making. Most of those interviewed held the view that information on material risks is unavailable or difficult to obtain.[11]

5.31 The BTGAS made a similar comment:

The current reporting requirements for publicly listed companies do not give investors sufficient information to understand the extent to which companies are managing social and environmental risks. While we do not advocate prescriptive legislation that would increase compliance costs for companies, we do believe some companies lack guidance on what information should be reported to long term investors. If a simple voluntary framework could be provided to at least give investors insight into the governance processes in place to assess social, environmental and corporate governance risks, investors could make up their own mind on these processes' sufficiency.[12]

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10 Mr Gerard Brown, General Manager, Corporate Affairs, Australia and New Zealand Banking Group, *Committee Hansard,* 5 April 2006, p. 40.

11 Coghill, Black, Holmes, *Submission 71*, p. 59.

12 BT Governance Advisory Service, *Submission 19*, p. 2.

5.32 The Ethical Investment Association of Australia set out the problem as follows:

> At present the disclosure required of corporations is inadequate for the financial markets to determine the entire operational, strategic and managerial capacity of a company. There are two reasons for this, and one is that many issues currently regarded as non-financial are not required to be reported on. I speak here, of course, about the company's environmental impacts, its impact on the health and wellbeing of society, its attitudes and practices regarding industrial relations management and human resource management, its practices in the communities in which it works, its practices in countries to which it outsources, its systems regarding adherence to a code of ethics, its governance procedures and so on.
>
> This information is not currently available in a format that is of use to analysts, unless they are specialised researchers in the area such as fund managers and analysts who specialise in sustainable responsible investment. While it may be plain to many that these issues do and will have an impact on the company's profitability, it is more likely that issues of this nature will take slightly longer to reach the bottom line than many other operational issues. The current structure of the financial markets and the corporate sector is such that long-term thinking goes unrewarded and is often penalised.[13]

5.33 Finally, as noted below, pressure for increased corporate responsibility disclosure is one of the UN's Principles for Responsible Investment. It is clear from this evidence that increased corporate responsibility reporting is not just a good for its own sake: it will allow markets to more adequately assess the risks and opportunities accruing to a company by virtue of its environmental and social positioning.

Duties of institutional investors

5.34 In chapter 4 of this report, the committee discussed the directors' duties found in the *Corporations Act 2001*, and the argument that these might preclude or at least inhibit corporate responsibility. The committee concluded that the Corporations Act itself does not preclude corporate responsibility.

5.35 Legislation places similar duties on those who operate institutional investment funds. The responsible entity of a managed fund, for instance, must 'act in the best interests of the members and, if there is a conflict between the members' interests and its own interests, give priority to the members' interests…'[14]

5.36 For regulated superannuation funds, the duty of the fund trustees is set out in section 62 of the *Superannuation Industry (Supervision) Act 1993*. The section is quite long and detailed, but in essence it provides for the 'core purposes' of providing

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13 Ms Louise O'Halloran, Executive Director, Ethical Investment Association, *Committee Hansard*, 23 November 2005, pp. 30-31

14 *Corporations Act 2001*, s. 601FC(1)(c)

various (financial) benefits to members[15] and 'ancillary purposes' of providing a somewhat wider range of (financial) benefits.[16]

5.37 Unsurprisingly, the duty placed on responsible entities by section 601FC of the Corporations Act was not raised in evidence before the committee. On its face, section 601FC does not limit the responsible entity to acting in the best *financial* interests of the members. Rather, the members are left to determine for themselves, through their constitution, what the best interests of the fund are to be.

5.38 The 'sole purpose test' was, however, raised before the committee. It was suggested that the sole purpose test operates to restrict superannuation trustees in the same ways in which directors' duties were said to constrain directors:

> A key barrier appears to be the interpretation of the sole purpose test with respect to CSR, as many of those interviewed felt that evidence of a material financial risk would be required to provide protection to fiduciaries if an investment decision is taken on CSR performance.[17]

5.39 A contribution by Blake Dawson Waldron to a 2005 UN Report stated that:

> Traditionally, Australian superannuation fund managers have taken the view that the sole purpose test precludes them from undertaking investment decisions based wholly or primarily on [corporate responsibility] considerations.[18]

5.40 The Financial Services Institute of Australasia (Finsia) submitted that to clarify the position between the sole purpose test and SRI investments, the Australian Prudential Regulation Authority (APRA) should issue detailed guidelines in order to give superannuation trustees more confidence in allocating investments to SRI fund managers.[19]

Committee view

5.41 The committee is not persuaded by a restrictive view of the sole purpose test. In chapter 4, the committee outlined its view that the argument does not stand in the case of directors' duties; it is even less compelling with respect to superannuation trustees. As the committee points out above, the very nature of superannuation investment is long term. Superannuation funds, perhaps more than any other group of investors, are placed to take advantage of long term opportunities, and are most

15 *Superannuation Industry (Supervision) Act 1993*, s. 62(1)(a)

16 *Superannuation Industry (Supervision) Act 1993*, s. 62(1)(b)

17 Coghill, Black, Holmes, *Submission 71*, p. 58.

18 United Nations Environment Programme Finance Initiative, *A legal framework for the integration of environmental, social and governance issues into institutional investment*, 2005, p. 45.

19 Financial Services Institute of Australasia, *Submission 146*, p. 9.

exposed to long term risks. In the committee's view, consideration of social and environmental responsibility is in fact so far bound up in long term financial success that a superannuation trustee would be closer to breaching the sole purpose test by ignoring corporate responsibility.

5.42 The committee can see no sensible interpretation of the sole purpose test which would constrain trustees from researching and considering companies' environmental and social performance, and making investment decisions influenced by that consideration.

5.43 To clarify the position for institutional investors the committee supports Finsia's suggestion that the APRA should issue detailed guidelines regarding the sole purpose test, to clarify for superannuation trustees their position in relation to allocating investments to ethical investment fund managers.

Recommendation 2

5.44 The committee recommends that the Australian Prudential Regulation Authority issue detailed guidelines on the sole purpose test to clarify for superannuation trustees their position in relation to allocating investments to sustainable responsible investment fund managers.

How active have institutional investors been?

5.45 Given that the committee has identified the potential of institutional investors to have a major impact on corporate responsibility, it is appropriate to consider how active they have been to this point. Evidence before the committee suggests that the picture for institutional investors is similar to that for corporations more broadly: attention to corporate responsibility issues is small but growing:

> Most of those interviewed believed that CSR would become an increasingly important factor in their roles over time. An indicative comment in this regard: 'It's on the radar and corporates are more nervous about it'. Advisers to the superannuation industry also commented on the growing importance of CSR, in one case noting that '[capabilities in CSR investment applications] are likely to be a factor for super funds in selecting advisers.'[20]

5.46 As discussed earlier the main reason for the lack of interest in this area on the part of institutional investors is the lack of non-financial information. Another reason identified for this relative lack of interest is that the economy has not yet suffered a major shock which is directly attributable to social or environmental factors. The report prepared by Ernst & Young for the Department of the Environment and Heritage, entitled *The Materiality of Environmental Risk to Australia's Finance Sector*, stated that their consultations had:

> … revealed a notable absence of known examples in Australia where finance sector participants are aware of having suffered substantial financial

20 Coghill, Black, Holmes, *Submission 71*, p. 55.

> losses due to environmental exposures. This is considered one of the main reasons why the debate on materiality or significance of the environmental risk to Australia's finance sector is not as advanced as the UK, Europe and USA.[21]

5.47 Major shocks have, however, been forecast. The committee is aware that the Senate Rural and Regional and Transport References Committee is currently conducting an examination into future oil supply, and is examining the forecast 'peak oil' crisis. If predictions are correct, then world oil production will shortly peak, then begin a long term decline, resulting in ever increasing prices (and therefore lower productivity for those companies which rely heavily on oil). Will it take a major shock to make markets aware of the potential impact of social and environmental factors? The committee hopes not. The recommendations contained in this report aim at making this less likely.

Assisting institutional investors

5.48 In chapter 4, the committee considered whether to make consideration of environmental and social factors a requirement for company directors. It concluded that this was the wrong approach, for three reasons: the duty cannot be expressed in law with appropriate clarity; it may lead to a simple, compliance-based exercise; and there are potentially successful non-regulatory measures which can be implemented. Those same arguments lead the committee to conclude that it would be inappropriate to try to use regulations to force institutional investors to take greater account of social and environmental factors.

5.49 The committee received evidence of several market drivers that have the potential to raise the importance of risk and corporate responsibility in the investment community. Finsia submitted that these are:

> - superannuation choice – there are many more people, especially Generation X and Y, who are making investment decisions for the first time;
> - emerging research that demonstrates SRI funds can offer equal, or superior, performance to mainstream funds;
> - greater understanding of the consequences of environmental risk to individual companies and whole industry sectors;
> - increased community expectation that corporations will not merely focus on short-term profits, but have regard to other stakeholders affected by their operations, and the potential impact on future generations; and

21 Ernst and Young, for the Department of the Environment and Heritage, *The Materiality of Environmental Risk to Australia's Finance Sector*, 2003, p. 2.

- the deepening pool of superannuation funds under management – the structure of super investments provides the longer-term perspective that is considered to be required for CSR.[22]

5.50 In addition, more and more institutional investors are obtaining expertise in the assessment of social and environmental risks and opportunities. When investing in overseas financial markets institutional investors are also increasingly exposed to corporate responsibility practices. These funds are making social and environmental assessment a mainstream element of their company research. The question for the committee is how to encourage and accelerate this growth.

5.51 The biggest impediment at present appears to be access to adequate, verifiable information about social and environmental risks. In chapter 7 of this report, the committee considers the adequacy of environmental and social reporting. That chapter contains recommendations which will support movement towards the provision of useful, verifiable, comparable information about a company's approach to corporate responsibility. The provision of such information reduces the time and complexity of research into corporate responsibility; and the increased reliability and comparability of the information makes it more likely that it can be included in an institutional investor's calculus for assessing companies.

United Nations Principles for Responsible Investment

5.52 The United Nations has for some time been considering the role of institutional investors in driving corporate social and environmental responsibility. A result of this process has been the development of the recently-released UN *Principles for Responsible Investment* (the UN Principles). The Principles are as follows:

(a) We will incorporate [corporate responsibility][23] issues into investment analysis and decision-making processes;

(b) We will be active owners and incorporate [corporate responsibility] issues into our ownership policies and practices;

(c) We will seek appropriate disclosure on [corporate responsibility] issues by the entities in which we invest;

(d) We will promote acceptance and implementation of the Principles within the investment industry;

(e) We will work together to enhance our effectiveness in implementing the Principles;

(f) We will each report on our activities and progress towards implementing the Principles.

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22 Financial Institute of Australasia, *Submission 146*, p. 4.

23 The Principles use the acronym ESG, for 'environmental, social, and corporate governance'. The committee has adjusted the UN Principles to use the consistent term 'corporate responsibility' rather than 'ESG'.

5.53 On the United Nations Principles for Responsible Investment internet site each principle is accompanied by suggested activities which institutional investors might undertake in order to implement the UN Principles.[24]

5.54 Unlike many UN activities, in which nation states are the signatories, the UN Principles are signed and adopted by institutional investors. As at 14 May 2006, investors from countries as diverse as Sweden, France, Thailand, Japan and the USA had signed up to the UN Principles. Just three Australian funds had done so: the Catholic Superannuation Fund, Christian Super, and Portfolio Partners Limited. The committee notes that the UN Principles are only very new, and considers that many other Australian institutional investors are likely to become signatories. The committee wishes to congratulate those three funds which have already done so.

Recommendation 3

5.55 The committee recommends that institutional investors in Australia seriously consider becoming signatories to the United Nations Principles for Responsible Investment.

5.56 The committee notes the establishment by the Australian Government in February 2006 of the Future Fund – a dedicated financial asset fund to meet unfunded superannuation liabilities of the Commonwealth.[25] The committee considers that with the establishment of the Future Fund, the Australian Government has an opportunity to show significant leadership in the area of corporate responsibility. While the committee recognises that the fund will be managed at arm's length from government, it remains appropriate for the Australian Government to set out general principles for the fund to follow. This point was acknowledged by the Senate Economics Legislation Committee which inquired into the Future Fund Bill 2005. The Economics committee stated: 'it may be appropriate to include principles in the directions to be given to the Board provided for under the investment mandate provisions of the Bill.'[26] The committee notes that such principles could include signing up to the UN Principles.

Recommendation 4

5.57 The committee recommends that the Future Fund should become a signatory to the United Nations Principles for Responsible Investment.

Conclusions

5.58 The committee considers that institutional investors are in an excellent position to drive corporate responsibility in Australia. Because institutional investors often have long term investment timeframes, they are positioned to take advantage of

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24 http://www.unpri.org

25 Explanatory Memorandum, Future Fund Bill 2005, p. 2.

26 Senate Economics Legislation Committee, *Provisions of the Future Fund Bill 2005*, February 2006, p. 12.

long term opportunities, and are exposed to long term risks. Through improved non-financial risk management, institutional investors are also one of the likely beneficiaries of increased adoption of corporate responsibility.

5.59 In previous chapters in this report, the evidence presented has been that there is often an underlying assumption of incompatibility between the interests of shareholders and the interests of other stakeholders. For institutional investors, activities which maximise corporate responsibility are likely to be in their long term interests, as much as those activities are in the interests of the environment or communities connected to the corporation. If the interests of institutional shareholders parallel the interests of other stakeholders, enlightened self-interest should suggest that there is no reason for corporations to shy away from corporate responsibility.

CHAPTER 6

SUSTAINABILITY REPORTING: BACKGROUND AND CURRENT STATUS

6.1 Term of reference (f) for this inquiry requires the committee to consider 'the appropriateness of reporting requirements associated with these issues.'

6.2 Sustainability reporting refers to the practice of corporations and other organisations measuring and publicly reporting on their economic, social and environmental performance. The sustainability performance information may be presented as part of an organisation's annual report, or in a stand alone report such as a sustainability report, a triple bottom line report, or an environmental or social impact report. It is one of the key ways in which companies demonstrate, and are being judged on, their commitment to corporate responsibility.

6.3 Sustainability reporting emerged as a significant issue in this inquiry, and a great deal of evidence was received by the committee on the subject. In particular, many participants expressed support for a reporting solution as the preferred way of encouraging corporate responsibility among Australian companies.[1]

6.4 This chapter provides a background to the debate on sustainability reporting and addresses:

- The benefits of, and impediments to sustainability reporting;
- The principles that should underpin sustainability reporting;
- The current status of sustainability reporting in Australia; and
- Overseas developments in sustainability reporting.

6.5 The following chapter will go on to address the current requirements for reporting in Australia, either under legislation, or by the market.

Benefits and impediments

6.6 In Australia sustainability reporting is voluntary. Companies which choose to prepare sustainability reports do so for a range of reasons including:

- informing non-shareholder stakeholders (such as employees and customers) about the societal and environmental impacts of a company's performance and the strategies in place or being developed to improve such impacts;

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1 For example, Mr Jeremy Cooper, Deputy Chairman, Australian Securities and Investments Commission, *Committee Hansard,* 29 March 2006, p. 11.

- assisting shareholders, investors and the market to determine how well companies are dealing with material non-financial and financial risks; and
- enabling companies to:
  - identify areas of operational or management improvement;
  - identify and better manage their non-financial risks;
  - identify new markets or business opportunities;
  - benchmark their performance against their competitors;
  - improve their reputation; and
  - recruit and retain high calibre staff.

6.7 According to Certified Practicing Accountants Australia's (CPA Australia) report *Sustainability – Practice, Performance and Potential*, there is a strong correlation between sustainability reporting and low probability of corporate distress. CPA Australia submitted that:

> This relationship may suggest companies that issue sustainability reports are more aware of the wider range of risks that may impact on the business and also further demonstrates that the longer term and more holistic approach to enterprise risk managements rewards both shareholders and stakeholders.[2]

6.8 Sustainability reports are prepared to convey non-financial information to a number of company stakeholders. According to the Centre for Australian Ethical Research's recent survey on sustainability reporting the main target audience for sustainability reports are employees (87%); customers (79%); shareholders (74%); local community (67%); institutional investors (54%); suppliers (59%); analysts (51%) and governments and NGOs (28%).[3]

6.9 The major impediment to the uptake of sustainability reporting is the cost and resources associated with their preparation. In its submission, KPMG cited research it undertook with the Centre for Australian Ethical Research, entitled *State of Sustainability Reporting in Australia 2005* (the CAER report), which shows that 78 per cent of respondents thought that cost and resource constraints were a barrier to sustainability reporting.[4] Wesfarmers for example quoted a figure of around $150,000, which includes printing and auditing but excludes the cost of staff time.[5]

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2 CPA Australia, *Submission 103*, p. 4.

3 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 31.

4 KPMG, *Submission 53*, p. 3.

5 Mr Keith Kessell, Executive General Manager, Corporate Affairs, Wesfarmers Ltd, *Committee Hansard*, 20 February 2006, p. 42.

6.10 It is worth noting that there is a significant initial hurdle for a corporation to commence sustainability reporting. The complexities of introducing a new and unfamiliar reporting regime may be an insurmountable upfront hurdle for some organisations. The initial set up costs involved with selecting a framework and establishing appropriate information channels within the organisation are likely to be one-off costs in year one. In subsequent years, the cost and resources required to prepare a sustainability report are likely to diminish significantly as organisations are be able to use results from previous years as a starting point (and ask what has changed) and as employees become familiar with the preferred framework and type of information required. In recognition of the high initial cost burden of sustainability reporting, the committee makes a recommendation in chapter 8 that the Australian Government should examine the feasibility of introducing inflated write-off arrangements for the year-one costs of producing sustainability reports.

6.11 Based on his experience in dealing with companies involved in the Corporate Responsibility Index, the first-year hurdle problem was described well by Dr Longstaff of the St James Ethics Centre:

> The major reason, we are told, is to do with a resource constraint within companies in the first year in which they do this. It is not actually doing it [the CSR activity]; it is the data assembly which is costly and time consuming. ...
>
> The good thing about it is that, under the [Corporate Responsibility Index] process, in year 2, year 3 and subsequently, it is also possible to reduce all of that work by around two-thirds, as we have been told by companies that have been doing this for a while, because the data from one year to another are rolled over on the system. Then you only have to deal with any material change that takes place within the index as a result of changes that we put through as a result of a consultative process involving NGOs and business and flowing through with our partners in the UK and Japan.
>
> So it becomes sustainable after that, but it is that first-year hurdle...[6]

6.12 Evidence put before the committee also shows that there is a range of benefits and impediments to the independent verification of sustainability reports. The practice of auditing sustainability reports is seen to enhance a report's credibility, and provide more reliable information, while adding an additional cost burden to the process. There is also a concern that there are a limited number of credible, professional, specialist companies available to conduct an independent audit.

Principles of sustainability reporting

6.13 From the evidence presented to the committee, several common themes emerged regarding the principles that should underlie sustainability reporting. This section discusses these principles in turn.

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6 Dr Simon Longstaff, Executive Director, St James Ethics Centre, *Committee Hansard*, 23 November 2005, p. 24.

Voluntary or mandatory

6.14 In Australia, sustainability reporting is voluntary. Both Commonwealth and state/territory legislation covers aspects of relevance to corporate responsibility such as environmental and health and safety issues. However such legislation only covers specific subject matter and does not constitute a sustainability reporting framework.

6.15 Evidence to the committee indicated that those corporations and industry associations that supported the continuation of voluntary sustainability reporting did so for two main reasons: mandatory reporting would impose additional costs on business and it would lead to a compliance mentality.

Additional cost

6.16 Mr Sheehy of Chartered Secretaries Australia (CSA) stated that mandatory reporting would add a significant layer of additional compliance costs to the operations of the majority of Australian companies. Mr Sheehy went on to give an example of the cost implications of such mandatory regulation:

> We have surveyed our members from time to time. ... The number that was bandied around was $50,000 just to meet the ASX Corporate Governance Council's guidelines. For smaller organisations that is a significant cost. The cost of meeting compliance requirements is high and is always increasing.[7]

Compliance mentality

6.17 CSA also outlined the problems associated with organisations adopting a compliance mentality:

> mandating has the usual catchphrase of a 'tick the box' and we would prefer that companies arrive at the conclusion that there is value for them in adopting reporting against these sorts of things. Even with the [ASX] Corporate Governance Council guidelines ... there were a number of companies that changed their practices against their best interests because they just did not want to put up with the flak of explaining why they had not done so. That is a dangerous development.[8]

6.18 Several submitters, whilst suggesting that the current reporting sustainability requirements are insufficient for a variety of reasons, were still of the view that it is too early to introduce a mandatory requirement. For example, Corporate ResponseAbility submitted 'at this stage, it would be premature to require mandatory

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7 Mr Tim Sheehy, Chief Executive, Chartered Secretaries Australia, *Committee Hansard*, 23 November 2005, p. 42.

8 Mr Tim Sheehy, Chief Executive, Chartered Secretaries Australia, *Committee Hansard*, 23 November 2005, p. 50.

reporting by Australian listed companies as the appropriate accounting and auditing procedures are still in development.'[9]

6.19 Submitters that supported the introduction of mandatory sustainability reporting did so for three main reasons: improved management of non-financial risks, investor's ability to value non-financial risks properly, and greater accountability and transparency. Several investment organisations supported a minimalist form of mandatory sustainability reporting, limited to just a few key performance indicators. These submissions are discussed in chapter 7.

Management of non-financial risks

6.20 This rationale was effectively described by Dr Black, who gave evidence that:

> ...mandatory reporting benefits many stakeholders but most particularly the corporations themselves. ... The corporations benefit because it requires them to establish systems and structures for understanding and addressing their broad ranging impacts and it can help them to better manage new types of risk that they may not previously have addressed.[10]

Valuing non-financial risks

6.21 This argument is reminiscent of the main justification of mandatory financial disclosure requirements – to protect investors.[11] Dr Black described how mandatory sustainability reporting allows institutional investors to get a better overall picture of company value by having access to information on non-financial risks. She said:

> Investors benefit because they have better quality information on corporate value drivers with which to make investment decisions and that benefits a huge number of Australians because we have so much invested in compulsory superannuation.[12]

Accountability and transparency

6.22 Several submitters suggested that there is a need for mandatory sustainability disclosures to give stakeholders confidence that companies are operating accountably and transparently. For example Mr Masson of the Finance Sector Union stated:

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9 Corporate ResponseAbility, *Submission 93*, p. 8. However, the submission went onto say 'it is reasonable for all listed ASX 100 companies to be encouraged to produce their first CSR report by 2007, and all ASX 200 companies by 2009.'

10 Dr Leeora Black, Managing Director, Australian Centre for Corporate Social Responsibility, *Committee Hansard*, p. 102.

11 R. P. Austin, & I. M. Ramsay, *Ford's Principles of Corporations Law*, 12th Edition, Sydney, 2005, p. 499.

12 Dr Leeora Black, Managing Director, Australian Centre for Corporate Social Responsibility, *Committee Hansard*, 24 February 2006, p. 102.

> I would like to see those players that currently ignore CSR come up to the standard, even if it is a minimum, because it will be something against which we can hold them to account.[13]

6.23 Mr Ensor of Oxfam Australia suggested that:

> ...mandatory mechanisms are required to ensure that Australian companies are socially and environmentally responsible, transparent and accountable to their stakeholders.[14]

6.24 Dr Anderson of Monash University gave a somewhat frank account of the accountability argument:

> ...mandatory reporting ... makes [companies] disclose exactly what they are doing and therefore they will fear how the community judges them and they will clean up their act ... Maybe you do not need to change the directors' duty section if you totally expose what they really do. That would support the mandatory introduction of the reporting.[15]

Cost-effective

6.25 Throughout the inquiry the high and at times prohibitive cost of preparing sustainability reports was identified as a major impediment to its increased uptake. The CAER report indicated that 'for the last three years [2003–2005] companies have been consistent in their identification of cost and resource constraints as the key impediment to sustainability reporting.'[16] It went on to recommend that 'initiatives be developed that will reduce the cost of sustainability reporting, and that such initiatives should remain consistent with the GRI.'[17]

6.26 A representative of the Department of the Environment and Heritage (DEH) gave evidence that cost-effectiveness was one of the key considerations in Senator Campbell's reference to the ASX Corporate Governance Council (discussed in chapter 7). He stated: 'what is being looked at is a consistent framework which works for Australia and which provides the comparability and cost-effectiveness'.[18]

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13 Mr Rod, Masson, Manager, Policy and Communications, Finance Sector Union, *Committee Hansard*, 23 February 2006, p. 42.

14 Mr James Ensor, Director, Public Policy and Outreach, Oxfam Australia, *Committee Hansard*, 24 February 2006, p. 19.

15 Dr Helen Anderson, Acting Head of Department, Department of Business Law and Taxation, Monash University, *Committee Hansard*, 24 February 2006, p. 71.

16 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 42.

17 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 42.

18 Mr Gene McGlynn, Assistant Secretary, Department of the Environment and Heritage, *Committee Hansard*, 27 March 2006, p. 30.

6.27 The principle of cost-effectiveness is particularly important in relation to small to medium enterprises. These companies will typically have a lower degree of social and environmental impact than their larger counterparts and also a lesser capacity to meet the costs of reporting. In this regard, the formulation used in the *EU Accounts Modernisation Directive* (discussed below) is worth mentioning. The Directive requires the disclosure of non-financial information 'in a manner consistent with the size and complexity of the business'.[19]

Flexibility

6.28 To meet the diverse needs of Australia's business community, flexibility was recognised as a key principle of sustainability reporting. Mr Matheson of the Australian Investor Relations Association encapsulated the essence of the notion saying 'an approach that provides flexibility ... to listed entities to consider and then disclose that sustainability or non-financial information that is pertinent to the company and its stakeholders is the preferred approach.'[20]

6.29 The ASX Corporate Governance Council's *Principles of Good Corporate Governance and Best Practice Recommendations* (ASX Council Recommendations) provide a good example of a flexible approach. The ASX Council Recommendations, which were outlined in chapter 2 of this report, state:

> The size, complexity and operations of companies differ, and so flexibility must be allowed in the structures adopted to optimise individual performance. That flexibility must, however, be tempered by accountability – the obligation to explain to investors why an alternative approach is adopted – the 'if not, why not' obligation.[21]

6.30 The 'if not, why not' construction was seen favourably by submitters such as the Australian Institute of Company Directors which submitted 'the flexibility of the ASX Principles' 'if not, why not' approach is preferable and achieves the goal of enhanced disclosure without stifling flexibility...'[22]

Comparability

6.31 The lack of comparability of non-financial information was seen by many submitters as a key deficiency in current sustainability reporting practices in Australia. The DEH noted 'there is a strong view in the community that inconsistency in [sustainability] reporting is limiting the maximising of the benefits that reporting can

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19 Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003, Official Journal of the European Union, 17 July 2003, p. L178/17.

20 Mr Ian Matheson, Chief Executive Officer, Australian Investor Relations Association, *Committee Hansard*, 27 March 2006, p. 2.

21 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, foreword.

22 Australian Institute of Company Directors, *Submission 73*, p. 18.

deliver.'[23] Two other government agencies, the Treasury and ASIC, expressly recognised that sustainability disclosures should be readily comparable.[24]

6.32 The level of inconsistency apparent in current reporting practices was aptly described by Mr Cohn of RepuTex:

> ...at the moment there is a large degree of disparity between the different sorts of sustainability or social responsibility or triple bottom-line reports that are produced. Some focus almost exclusively on charitable donations or philanthropic activities engaged in by the companies, whereas others engage in detailed reporting of material substantive risks and impacts that are relevant to the company.[25]

6.33 The inconsistency derives from the fact that in Australia there is no common sustainability reporting framework. This has prompted the Environment Minister, Senator the Hon Ian Campbell, to refer the question of the inclusion of a voluntary standardised framework to the ASX Council Recommendations.

6.34 The significant market implications of inconsistent sustainability information were highlighted in a research report, *Sustainability – Practices, Performance and Potential*, undertaken for CPA Australia. This research, which examined sustainability reporting by Australian companies:

> ...clearly shows that its value and contribution to more informed stakeholders is undermined by the absence of a common reporting framework. Without a common basis to reporting, users are unable to compare information across time and across companies and so penalise or reward companies. This outcome is reflected in the failure of capital markets to value sustainability information and suggests that market forces are unlikely to drive future improvements to sustainability reporting and by association corporate practices.[26]

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23 Mr Gene McGlynn, Assistant Secretary, Department of the Environment and Heritage, *Committee Hansard*, 27 March 2006, p. 29.

24 Mr Matthew Brine, Manager, Governance and Insolvency Unit, Department of the Treasury, *Committee Hansard*, 29 March 2006, p. 18; and Australian Securities and Investments Commission, *Submission to the Corporations and Markets Advisor Committee's Corporate Social Responsibility inquiry*, p. 3, http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFSubmissions_2/$file/ASIC_CSR.pdf (accessed 30 may 2006).

25 Mr Philip Cohn, Assistant Director, RepuTex Australia Pacific, *Committee Hansard*, 23 February 2006, p. 23.

26 CPA Australia, *Submission 103*, p. 4.

6.35 In this regard the Environment Minister has commented that 'Australian companies will need to improve the quality and comparability of reports to ensure they are more business relevant.'[27]

6.36 It was widely recognised that if a common reporting framework were to be adopted in Australia, due to the globalised nature of world financial markets, it would need to be consistent with international approaches. Ms O'Halloran of the Ethical Investment Association made the point this way:

> It would be folly to go down any route other than to have a global reporting standard. I just think it would be a waste of time. ... So much of the investment markets that operate within Australia happen on an international level, so analysts need to be able to compare and contrast between sectors and between companies within sectors on a global basis. They are competing for that investment firm's money with the same risk parameters, the same opportunities and the same uncertainties. They need to be able to compare and contrast on that level.[28]

6.37 It was almost universally acknowledged that the Global Reporting Initiative (GRI) is the emerging international standard for sustainability reporting. According to DEH:

> There are a number of frameworks available for non-financial reporting. Over the past few years however it has become clear that the [GRI] is emerging as the most widely used international framework for reporting.
>
> The 2005 KPMG International Survey of Corporate Responsibility Reporting found the GRI Guidelines are the most common tool used to decide report content and 40% of reporters world-wide mention the use of these guidelines in their sustainability reports.
>
> Currently, over 700 organisations world-wide are identified as users of the GRI Guidelines for reporting, a dramatic increase over the approximately 200 listed in 2003. In Australia, the 2004 State of Sustainability Reporting survey showed that 40 companies were making use of the GRI guidelines.[29]

6.38 The GRI is discussed in detail in a later section of this chapter.

6.39 There were concerns expressed by several submitters regarding the possible introduction of a common sustainability reporting framework, including whether it would be sufficiently flexible to accommodate Australia's diverse market, and the

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27 Senator the Hon Ian Campbell, Foreword to a report by the Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 1.

28 Ms Louise O'Halloran, Executive Director, Ethical Investment Association, *Committee Hansard*, 23 November 2005, p. 33. This view was endorsed by Mr Matthew Brine, Manager, Governance and Insolvency Unit, Department of the Treasury, *Committee Hansard*, 29 March 2006, p. 26.

29 Department of the Environment and Heritage, *Submission 116*, p. 5.

potentially onerous undertaking required to be fully 'in accordance with' the GRI framework.

6.40 In regard to the former issue, Mr Sheehy of CSA questioned the GRI's flexibility, stating that 'I cannot imagine that any one reporting framework would suit absolutely every organisation.'[30] He went on to concede that a sectoral approach (which is available in certain sectors under the GRI) would overcome these difficulties.

6.41 In relation to the latter, the GRI allows companies to self-identify relevant indicators and then only report on those parts and indicators that are applicable to each company. Furthermore the GRI can be incrementally implemented over a number of years, allowing companies to prioritise important elements in the early years of reporting and then to expand the scope over time.

Committee view

Reporting should remain voluntary

6.42 The committee agrees with the GRI's submission which states:

> ...it is increased quality and quantity of reporting that is more relevant [than whether reporting is voluntary or mandatory]. Different approaches will be needed to achieve this goal in different places, depending on the cultural context, legal and economic frameworks, and the level of understanding between stakeholders.[31]

6.43 The committee acknowledges the various benefits that mandating sustainability reporting would bring, such as improved management of non-financial risks, investor protection and accountability. On balance however, the committee does not believe that there are sufficiently compelling reasons to move from a voluntary to a mandatory framework.

6.44 The committee also agrees with the view of the Business Roundtable on Sustainable Development that mandating sustainability reporting is an inappropriate response to the current pressures,[32] and notes the view that there may be increasing pressure on the legislature to intervene if companies fail to act.

6.45 The committee has concerns that mandating sustainability reporting in the current Australian context would promote form over substance. As a result of these

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30 Mr Tim Sheehy, Chief Executive, Chartered Secretaries Australia, *Committee Hansard*, 23 November 2005, p. 49.

31 Global Reporting Initiative, *Submission 130*, p. 4.

32 Business Roundtable on Sustainable Development, *Submission to the Corporations and Markets Advisory Committee's Corporate Social Responsibility inquiry*, p. 2, http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFSubmissions_2/$file/BRSD_CSR.pdf (accessed 30 May 2006).

issues the committee believes that it is vitally important for companies to be encouraged strongly to engage voluntarily in sustainability reporting rather than being forced to do so.

Recommendation 5

6.46 The committee recommends that sustainability reporting in Australia should remain voluntary.

6.47 Despite this recommendation the committee finds persuasive the view put by ASIC in evidence that increasing the level of reporting may be a better way to encourage corporate responsibility than seeking to mandate it through an amendment to directors' duties.[33]

Cost-effective

6.48 The committee believes that the principle of cost-effectiveness is a central concern that will influence the level and nature of sustainability reporting in Australia. The committee makes a recommendation to improve the cost-effectiveness of companies responding to requests for sustainability information and investors and stakeholders seeking out sustainability information in chapter 8 (Recommendation 16).

Flexible

6.49 The committee supports the principle of flexibility in sustainability reporting, noting that the ASX Council's 'if not, why not' approach provides a balanced mechanism to achieve flexibility.

Comparability

6.50 The committee fully supports Senator Campbell's reference to the ASX Corporate Governance Council. The committee acknowledges the importance of moving towards an internationally recognised framework as the Australian voluntary sustainability reporting standard. In chapter 7 the committee makes a recommendation in relation to the GRI.

Forms of sustainability reports

6.51 Sustainability reporting currently takes various forms and is referred to by many names. As noted above, sustainability reporting refers to the practice of corporations and other organisations measuring and publicly reporting on their economic, social and environmental performance. The sustainability performance information may be presented as part of an organisation's annual report, or in a stand

33 Mr Jeremy Cooper, Deputy Chairman, Australian Securities and Investments Commission, *Committee Hansard,* 29 March 2006, p. 11.

alone report. Non-financial information is also often presented less formally as part of a company's Internet website.

6.52 The precursors to sustainability reporting were single issue reports that focussed on either environmental or social performance. The titles of these early non-financial reports, for example 'community impact report', 'stakeholder impact report' or 'environmental impact report' reflect their one-dimensional nature.

6.53 Over time, as the concept of sustainability has gained wider acceptance and credence, the presentation of non-financial information is coalescing in integrated sustainability reports. Today there is a worldwide trend toward greater use of sustainability reports instead of other types of non-financial reports, and this is also evident in trends across Australia.[34]

Committee view

6.54 The committee is of the view that the concept of 'sustainability reporting' is preferable to other notions of integrated financial and non-financial reporting. There are obvious similarities between sustainability reporting, triple bottom line reporting and corporate responsibility reporting. They all refer to the practice of organisations reporting on their economic, social and environmental performance. In the committee's view the label 'sustainability report' is preferable for two reasons. Firstly, sustainability reporting is a broader concept than triple bottom line reporting. The concept of sustainability encompasses a long-term perspective which triple bottom line reporting does not. Indeed, sustainability reports will often have forward looking elements as well as outlining past company performance. Sustainability reporting therefore takes into account a broader range of future non-financial risks.

6.55 The other reason for preferring the label 'sustainability reporting' is a practical one. A recent CPA Australia's survey found that respondents were far more familiar with the concept of 'sustainability' than 'triple bottom line'.[35] Of the 300 members of the public that were surveyed, 90 per cent were aware of the term 'sustainability' whereas only 27 per cent were aware of the term 'triple bottom line reporting'. Across the entire range of survey participants, which also included shareholders, investment analysts and company directors the results were 95 per cent recognition of the term 'sustainability' compared to only 48 per cent of the term 'triple bottom line reporting'. Throughout the remainder of this report the term sustainability reporting will be used.

Taxonomy

6.56 Before discussing the issues raised in relation to the appropriateness of sustainability reporting in Australia it is useful to give some detail on the types of

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34 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 38.

35 CPA Australia, *Submission 103b*, p. 6.

reporting framework and other policy instruments that are relevant in this area, as well as the different types of non-financial reports that are produced. Broadly speaking the various forms of reporting frameworks can be divided into three main categories – codes, standards and reporting guidelines. Arguably, codes and standards are equally relevant to how a company performs as to what a company reports. These two categories are included in this section because often it is a code or a standard that is the information being disclosed by a company. The main examples of each of these categories are presented below.

Codes of conduct

6.57 Codes of corporate conduct are voluntary initiatives which set out a series of principles or values which corporations may adopt to guide their criteria for decision-making and its ground rules for appropriate corporate behaviour. An increasing number of organisations are realising the importance and value of explicitly communicating their values and guiding principles in a published code of conduct. An important driver for this shift is the heightened concern resulting from corporate scandals and their impact on the capital markets and investors. Questionable business practices and even individual incidents of improper conduct reflect, to some degree, the values, attitudes and beliefs of the organisation in which they occur.

6.58 Given their broad and voluntary nature, there are obvious practical limits to the effectiveness of codes of conduct. Unless they form part of a company's key performance indicators or reporting requirements, codes can be passive and ineffective documents. Ms Cox noted their practical limits stating:

> Codes of conduct can be useful but are limited where these attempt to specify behaviour which may not be owned or practiced. Sometimes these documents may be unknown to the organisations, others may be seen as either too ambitious or not practical, others may be too specific and therefore failing to give wider guidance.[36]

6.59 However, as the commentary to the ASX Council Recommendations recognises, while it is not possible to regulate the personal integrity of directors and senior executives:

> ...investor confidence can be enhanced if the company clearly articulates the practices by which it intends directors and key executives to abide.
>
> Each company should determine its own policies designed to influence appropriate behaviour by directors and key executives. A code of conduct is an effective way to guide the behaviour of directors and key executives and demonstrate the commitment of the company to ethical practices.[37]

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36 Ms Eva Cox, *Submission 26*, p. 3.

37 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 25.

Principles 3 and 10, ASX Council Recommendations

6.60 In Australia there is an expectation for publicly listed companies and trusts to establish a code of conduct to promote actively ethical and responsible decision making. This expectation arises from the ASX Council Recommendations which are discussed in more detail in the following chapter. Briefly, Principle 3 of the ASX Council Recommendations states:

> The company should:
>
> - clarify the standards of ethical behaviour required of company directors and key executives ... and encourage the observance of those standards
> - publish its position concerning the issue of board and employee trading in company securities and in associated products which operate to limit the economic risk of those securities.[38]

6.61 Principle 10 of the ASX Council Recommendations which relates to the recognition of the legitimate interests of stakeholders is also relevant. It acknowledges that 'it is important for companies to demonstrate their commitment to appropriate corporate practices.'[39]

6.62 In order to satisfy these principles the ASX Corporate Governance Council recommends that corporations establish a code of conduct to:

- guide the directors, the chief executive officer (or equivalent), the chief financial officer (or equivalent) and any other key executives as to:
  - the practices necessary to maintain confidence in the company's integrity;
  - the responsibility and accountability of individuals for reporting and investigating reports of unethical practices (Recommendation 3.1); and
- guide compliance with legal and other obligations to legitimate stakeholders (Recommendation 10.1).[40]

6.63 The ASX Council Recommendations provide useful non-prescriptive guidance and suggestions for the content of a code of conduct.

6.64 As noted earlier, the ASX Council Recommendations only apply to publicly listed companies and trusts. For this reason both the NSW Young Lawyers and Mr Wishart expressed support for a legislative amendment to enable the introduction

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38 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 25.

39 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 59.

40 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, pp 25 and 59.

of a code of conduct to all entities governed by the *Corporations Act 2001*.[41] Mr Wishart suggested that this could be achieved by way of a replaceable rule. The committee notes in this regard that there is already an Australian Standard, AS 8003-2003, which relates to organisational codes of conduct. This standard sets out the essential elements for establishing, implementing and managing an effective organisational code of conduct and applies equally to listed and non-listed entities.

UN Global Compact

6.65 The Global Compact is an initiative of the United Nations that facilitates a network of UN agencies, governments, business, labour, and non-government organisations to encourage companies to adopt ten principles in the areas of human rights, labour, environment, and anti-corruption.

6.66 The Global Compact is a voluntary initiative that seeks to promote responsible corporate citizenship. It seeks to advance ten universal principles drawn from the Universal Declaration of Human Rights, the International Labour Organisation Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development and the UN Convention against Corruption. The principles call for business to support and protect human rights, respect workplace rights, take greater environmental responsibility and work against corruption.

6.67 The Global Compact is not a regulatory instrument. It does not enforce or measure the behaviour or actions of companies. Rather, the Global Compact relies on public accountability, transparency and the enlightened self-interest of companies, labour and civil society to initiate and share substantive action in pursuing the principles upon which the Global Compact is based.[42]

6.68 Companies voluntarily participating in the Global Compact have the opportunity to engage in a range of multi-stakeholder networks to assist them to implement and advocate the principles. Companies are encouraged to develop their examples of corporate change into case studies and are expected to publish in their annual report or sustainability report a description of the ways in which they are supporting the Global Compact and its ten principles. There are a range of publications to assist companies in implementing the principles.

6.69 Some submitters rejected the UN Global Compact as 'a contrivance to entice the corporate world to deliver on [a number of UN conventions].'[43]

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41 NSW Young Lawyers Pro Bono and Community Services Taskforce, *Submission 65*, pp 17–19 and Mr David Wishart, *Submission 140*, p. 9.

42 www.unglobalcompact.org/AboutTheGC/index.html (accessed 20 April 2006)

43 The Hon Dr Gary Johns, *Attachment to Submission 126*, p. 2.

6.70 Despite this criticism, a number of leading Australian companies that appeared before or provided submissions to the committee are signatories to the Global Compact, including Shell Australia, BHP Billiton, Westpac, Newmont Australia, Future Eye and RMIT University. The number of Australian organisations that are signatories to the Global Compact is steadily growing, with the total currently standing at 20. There are also a number of foreign-owned companies operating in Australia, the parent company of which is a signatory. World-wide there are around 3000 businesses and organisations that are participants.

OECD Multinational Enterprises Guidelines

6.71 Australia is a signatory to the *OECD Declaration on International Investment and Multinational Enterprises* (OECD Guidelines), non-binding guidelines that provide voluntary principles and standards for responsible business conduct. The OECD Guidelines establish principles of corporate responsibility covering a broad range of issues including human rights, information disclosure, employment and industrial relations, environment, combating bribery and consumer interests. Guidelines have been prepared in consultation with business and trade union representative bodies, as well as non-government organisations. The OECD Guidelines apply to the operations of multinational enterprises, even in non-OECD countries, and require Multinational Enterprises (MNEs) to 'encourage, where practicable, business partners, including suppliers and subcontractors, to apply principles of corporate conduct compatible with the Guidelines.'[44]

6.72 The Treasury which has a role promoting and implementing the OECD Guidelines as the National Contact Point, stated:

> Observance of the OECD guidelines by enterprises is voluntary and not legally enforceable. However, governments adhering to the OECD guidelines are committed both to promoting the guidelines and establishing National Contact Points to act as a forum for discussion of all matters relating to the guidelines, including the review of 'specific instances'. An important aspect of the OECD guidelines is the formal review mechanism that allows parties to raise 'specific instances' in which the behaviour of enterprises may have been inconsistent with the guidelines. The Australian National Contact Point for the OECD guidelines is the Executive Member of the Foreign Investment Review Board.[45]

6.73 According to Dr Sean Cooney of the Centre for Employment and Labour Relations Law, University of Melbourne, there have been no 'specific instance' complaints relating to Australian operations since 2000, while there have been 64 complaints in other parts of the world over the same period.[46]

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44 Organisation for Economic Co-operation and Development, *OECD Declaration on International Investment and Multinational Enterprises*, November 2000, p. 11.

45 Department of the Treasury, *Submission 134*, p. 11.

46 Dr Sean Rooney, *Attachment to Submission 104*, p. 25.

6.74 Dr Cooney expressed support for the OECD Guidelines:

> ...the Guidelines have significant normative force, constituting an agreed statement of principles by the OECD nations. They appear to be playing a significant role as a reference point for policy-making in relation to CSR [for example Standards Australia's Corporate Governance, Corporate Social Responsibility and Bribery papers, Australia's Triple Bottom Line Reporting Guidelines, Australia's Environmental Reporting Guidelines and the Australian Securities and Investment Commission's Socially Responsible Investing Disclosure Guidelines]. Moreover, the Australian [National Contact Point] is actively promoting the Guidelines with Australian business and seeking to diffuse information about the Guidelines and other CSR initiatives through a well-developed website.[47]

6.75 Subsequent to Dr Cooney's submission, the committee has learnt of a recent 'specific instance' complaint that has led to a mediated outcome involving Global Solutions Limited Australia, the company responsible for the management and day to day operations of Australia's immigration detention centres.[48] This example demonstrates the effectiveness of the OECD Guidelines in improving corporate performance.

6.76 A number of other codes of conduct that relate specifically to one aspect of corporate responsibility were brought to the committee's attention. Examples in relation to human rights and labour standards included the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy, and the draft UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights.[49] Dr Zappalà points out that 'according to an OECD survey there were almost 250 voluntary codes of conduct with relevance to corporate citizenship.'[50]

Standards

6.77 The adoption of national and international standards is another voluntary way that corporations can obtain basic guidance about integrating corporate responsibility into their operations. The International Standards Organisation (ISO) has developed an extensive range of standards, some of which are directly related to aspects of corporate responsibility such as the ISO 14000 series on environment management systems. The ISO is developing the ISO 26000 Guideline for Social Responsibility, which is expected to be released in 2008.

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47 Dr Sean Rooney, *Attachment to Submission 104*, p. 25.

48 Statement by the Australian National Contact Point 'GSL Australia Specific Instance', April 2006, http://www.ausncp.gov.au/content/docs/298_343_Final%20Statement.pdf (accessed 30 May 2006).

49 Regarding the former, see for example the Australian Council of Trade Unions, *Submission 10*, and the latter, see for example the PILCH Homeless Persons' Legal Clinic, *Submission 4*.

50 Dr Gianni Zappalà, *Submission 2*, p. 12.

Australian Standard on Corporate Social Responsibility (AS 8003-2003)

6.78 In July 2003 Standards Australia released a specific voluntary standard on corporate responsibility that provides basic guidance about integrating corporate responsibility into operations (AS 8003-2003). It forms part of a five-part suite of corporate governance standards (AS 8000 Business Governance Suite). AS 8003-2003 sets out the essential elements for establishing, implementing and maintaining an effective corporate social responsibility program within an entity, and then goes into more detail by providing guidance as to how these elements should be used. The AS 8000 suite is aimed at all companies, including the smaller non-listed companies, both for profit and non-profit, that are not covered by the ASX Council Recommendations.

Assurance standards

6.79 There are also standards that apply to the independent verification of sustainability reports. Independent verification provides internal and external assurance that the data and content reported, and claims made, are validated by an independent party.

6.80 The most commonly used standard for independent verification is the AA1000 assurance standard. The AA1000 framework is a measurement tool devised by AccountAbility to complement and build upon the GRI Reporting Guidelines. It provides guidance on how to establish a systematic stakeholder engagement process that generates the indicators, targets and reporting systems needed to ensure its effectiveness in impacting on decisions, activities and overall organisational performance.

6.81 Another more recent assurance standard is the ISAE3000 developed by the International Assurance and Auditing Standards Board. It is a generic standard for assurance engagements including non-financial performance and conditions and behaviour, such as corporate governance and human resource practices.

Reporting guidelines

6.82 There are a number of frameworks available for non-financial reporting. There is also a range of reporting guidelines available in Australia that have been specifically tailored for the Australian context, which are discussed below.

Global Reporting Initiative

6.83 During the course of the inquiry, perhaps the most commonly used acronym aside from 'CSR' was 'GRI'. GRI stands for the Global Reporting Initiative, a multi-stakeholder process whose mission is to develop and disseminate globally applicable guidelines for sustainability reporting. According to the GRI submission:

> GRI's purpose is to make sustainability reporting as common and widespread as financial reporting so that it will be routine for companies and other organisations to account for the contributions they make to – and

the impact they have on – the globe's natural resources, societies, and economies.[51]

6.84 The organisation began in 1997 and became an independent institution in 2002. It is an official collaborating centre of the United Nations Environment Programme and works in cooperation with UN Global Compact.

6.85 The GRI *Sustainability Reporting Guidelines* (the GRI Guidelines) are for voluntary use by organisations for reporting on the economic, environmental, and social dimensions of their activities, products, and services. The GRI has a global network of experts from accountancy, business, civil society, investment, labour and others, who contribute on a voluntary basis to the governance of GRI and to the development and dissemination of the GRI Guidelines.

6.86 The GRI Guidelines include a set of 11 reporting principles that are aimed at producing informative, balanced, transparent and comparable sustainability reports. The principles include transparency, relevance, accuracy, neutrality, comparability and timeliness, some of which have similarities and overlaps with those used in financial reporting.

6.87 The GRI Guidelines also clearly set out expectations for the content of sustainability reports. Importantly, this section of the Guidelines includes a series of economic, social and environmental indicators that are broadly applicable to all organisations. The indicators are structured so that they elicit comparable information on the performance of many organisations. Not all indicators will be relevant to all organisations and the GRI encourages reporting organisations to consult with stakeholders and develop an appropriate shortlist of performance indicators to include in their reports.

6.88 There are several other complementary elements of the GRI Guidelines which go to make up the GRI Framework. These include:

- an expanding collection of Sector Supplements which provide specific guidance to assist with interpreting the Guidelines, and offer new indicators to ensure that reporting meets the focused needs of industry sectors and their stakeholders. Sector Supplements currently cover financial services, mining and metals, telecommunications, automotive, tour operators and public agencies; and
- a series of Technical Protocols, each designed to addresses a specific indicator or set of indicators by providing detailed definitions, procedures, formulae and references to ensure consistency across reports. Over time, most of the indicators in the GRI Guidelines will be supported by a specific technical protocol.

51 Global Reporting Initiative, *Submission 130*, p. 1.

6.89 Importantly, the GRI Framework has a range of flexibility mechanisms to enhance its applicability and accessibility to the enormously diverse range of organisations (large and small, public and private, for-profit and non-profit) that may wish to adopt the GRI reporting structure. The GRI Guidelines state:

> GRI encourages the use of the GRI *Guidelines* by all organisations, regardless of their experience in preparing sustainability reports. The *Guidelines* are structured so that all organisations, from beginners to sophisticated reporters, can readily find a comfortable place along a continuum of options.
>
> Recognising these varying levels of experience, GRI provides ample flexibility in how organisations use the *Guidelines*. The options range from adherence to a set of conditions for preparing a report 'in accordance' with the *Guidelines* to an informal approach. The latter begins with partial adherence to the reporting principles and/or report content in the *Guidelines* and incrementally moves to fuller adoption.[52]

6.90 In its submission, Insurance Australia Group (IAG) highlighted the importance of the flexibility of GRI Guidelines to corporations:

> One of the central features of the GRI Guidelines is the fact that participation is voluntary and organisations are permitted to report against any or all of the indicators. The flexibility in the number of indicators to be reported allows an organisation to build capability over time. In a practical sense, companies that have not previously measured social and environmental performance need time and resources to build and manage the systems that will enable them to measure, benchmark and improve performance across non-financial dimensions.[53]

6.91 As a result, the GRI Framework enables reporters to select an approach that is suitable to their individual organisations. GRI based reports are able to be customised in a number of ways. For example organisations are able to select performance indicators which are most relevant to their circumstances.[54]

6.92 There are also specially tailored guidelines available to support small to medium enterprises (SMEs) wishing to undertake sustainability reporting. The *High 5!* handbook is a 'beginner's guide' that offers guidance and practical advice to SMEs on using the GRI Guidelines.

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52 Global Reporting Initiative, *Sustainability Reporting Guidelines*, 2002, p. 13.

53 Insurance Australia Group, *Submission 29*, p. 20.

54 The GRI Guidelines classify performance indicators as either 'core' or 'additional,' with core indicators being those relevant to most reporting organisations and of interest to most stakeholders. Reporting organisations that choose to report 'in accordance' with the GRI Framework must note the reasons for the omissions of any core indicators. The factors that may explain the omission of a core indicator include protection of proprietary information; lack of data systems to generate the required information; and that a specific indicator is not relevant to an organisation's operations.

6.93 Throughout the inquiry the GRI Framework was repeatedly referred to as the internationally recognised standard for sustainability reporting. For example, Ms O'Halloran of the Ethical Investment Association stated:

> It has been so entrenched. At every single meeting I go to in any other country the Global Reporting Initiative is fully supported by organisations, by governments and by the financial markets. It seems to be a standard that is absolutely embraced worldwide.[55]

6.94 The GRI Framework is now used by over 800 organisations in 51 countries. As a result the GRI is used in the preparation of 40 per cent of sustainability reports worldwide.[56]

6.95 The proportion of Australian companies that are adopting the GRI is increasing rapidly. Between 2004 and 2005 the preparation of sustainability reports in Australia using the GRI Guidelines has grown from 30 to 51 per cent.[57]

6.96 The GRI is currently progressing through the third major revision of its Guidelines, at the conclusion of which the revised Guidelines, known as the G3, will be launched in October 2006. The G3 revision is intend to improve the robustness of the GRI Framework; cater more for investors and the capital market; provide digital solutions for the delivery of the G3 Guidelines; and development of educational support materials and programs. These refinements to the GRI have the potential to make them more accessible and applicable to a greater number of organisations.[58]

Australian reporting guidelines[59]

6.97 In 2003, the Department of the Environment and Heritage (DEH) developed a guide for public environmental reporting in the Australian context.[60] This guide, titled *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators* complements the GRI Guidelines by 'providing Australian organisations with tangible and easy to use methodologies for measuring performance

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55 Ms Louise O'Halloran, Executive Director, Ethical Investment Association, *Committee Hansard*, 23 November 2005, p. 34.

56 KPMG Global Sustainability Services, *KPMG International Survey of Corporate Responsibility Reporting 2005*, June 2005, p. 20.

57 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 4. The report shows that about 60 per cent of the companies using the GRI Guidelines are internationally owned.

58 Dr Judy Henderson, Chairperson, Global Reporting Initiative, *Committee Hansard*, 10 March 2006, p. 28.

59 This section is based in part on a submission by Mr Richard Turner, *Submission 5*, pp 19–20.

60 Department of the Environment and Heritage, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators*, June 2003.

against key environmental indicators'.[61] The DEH guide provides an eight-step process that organisations can follow in preparing a public environmental report. While the DEH guide is focused on environmental reporting, the steps set out in the DEH guide appear equally applicable to other aspects of sustainability reporting.

6.98 The DEH guide cites strong support for the GRI Framework during stakeholder consultation.[62] Some minor deviations from the GRI were adopted to address Australian conditions, reduce complexity, or in response to shareholder feedback. In providing a reporting framework the DEH guide makes the distinction between 'environmental management indicators' which 'provide information on how a company manages any environmental impacts of its operations, products and services', and 'environmental performance indicators' which 'calculate and report on the impact its operations have on the environment.'[63]

6.99 The DEH guide can be used by directors to discharge their duty if they are obliged under paragraph 299(1)(f) of the *Corporations Act 2001* to report on the company's environmental impact.

6.100 In 2004, the then Department of Family and Community Services released a draft guide to assist companies to report on their social impacts.[64] The draft guide is also based on the GRI Guidelines. As social indicators are less quantitative than environmental indicators, they tend to require more information about internal processes and policies than actual performance. As a result, the major challenge with social indicators is to ensure consistency with definitions in order to allow comparability. There was no indication in the submission from the Department of Family, Community Services and Indigenous Affairs whether, and if so when, it intends to finalise the draft guide.

6.101 There are several notable private sector initiatives in relation to developing guidelines for sustainability reporting.

6.102 In 2003, in order to facilitate the understanding of members, the Group of 100 (G100), representing the Chief Financial Officers of large business enterprises in Australia, produced a guide to sustainability reporting, *Sustainability: A Guide to Triple Bottom Line Reporting*. This guide is not a sustainability reporting guide as such. It is intended to provide an explanatory guide for senior executives considering

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61 Department of the Environment and Heritage, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators*, June 2003, p. iii.

62 Department of the Environment and Heritage, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators*, June 2003, p. 10.

63 Department of the Environment and Heritage, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators*, June 2003, pp 14 and 20, respectively.

64 Department of Family and Community Services, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Social Indicators*, Draft in Discussion, July 2004.

sustainability reporting, outlining concepts and key issues associated with sustainability reporting.

6.103 With the assistance of a $1 million grant from the Australian Government, CPA Australia and the University of Sydney are currently collaborating to develop a framework for managing and reporting non-financial information.[65] The Australian Accounting Standards Board has also announced it is looking at developing a standard for triple bottom line accounting.[66]

Sustainability indices

6.104 The growing importance of corporate responsibility to financial markets and the emergence of a new breed of investors known as ethical investors, has led to the establishment of sustainability indices. Sustainability indices seek to rank corporations with respect to their overall financial and non-financial performance and also allow investors to track the performance of sustainable investments. Overseas examples, which have developed more extensively than those in Australia, include the US's Dow Jones Sustainability Index, the UK's FTSE4Good, the Canadian Jantzi Social Index, and the South African Johannesburg Securities Exchange SRI Index.

6.105 By comparison, the emergence of sustainability indices in Australia has been slow, largely due to the low participation rates of Australian corporations in voluntary indices and the difficulties in accessing reliable non-financial information. The three main Australian sustainability indices are described below.

Corporate Responsibility Index

6.106 The committee notes the recently established Corporate Responsibility Index (CRI), in which participating *BRW* top 250 companies voluntarily agree to be ranked publicly on their non-financial performance. In 2005, 29 such companies agreed to participate, submitting themselves to a detailed self-assessment process subject to validation by Ernst & Young. Compiled annually, the third CRI was published in May 2006, listing the best performers of 2005. The top five participating companies were Westpac, Toyota Australia, ANZ, BHP Billiton and BOC group.[67]

6.107 According to Dr Longstaff of the St James Ethics Centre, which acts as the 'trustee' for the CRI in Australia and New Zealand:

> The most important features of the CRI are that it offers detailed information that helps corporations to improve their actual performance. Secondly, the reporting process leads to the publication of an Index

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65 Australian Bankers Association, *Submission 106*, p. 3: also CPA Australia, *Submission 103*, p. 34.

66 Australian Bankers Association, *Submission 106*, p. 3.

67 Corporate Responsibility Index webpage, http://www.corporate-responsibility.com.au/results/2005_results.asp (accessed 1 June 2006).

> available for examination by the broader community. ... we believe the CRI provides a powerful tool for encouraging an underlying culture of corporate responsibility.[68]

6.108 The CRI was launched in February 2004, and corporate Australia's participation in the CRI to date has been limited. In its inaugural year, around 10 per cent of Australia's top 250 companies which were invited to participate, did so. Despite the St James Ethics Centre's best endeavours to recruit more participants, the level of participation has only increased marginally in the subsequent two rounds. While giving evidence, Dr Longstaff expressed a degree of frustration at the slow level of take-up in Australia saying '[w]hen you think about it—it was a tool that was initially developed by business for business and it is free—you would ask why.'[69] By comparison, the United Kingdom's version of the CRI has nearly 150 participants, despite its launch occurring less than one year earlier.

6.109 Dr Longstaff suggested that the Government should support mechanisms such as the CRI:

> ...government has an important role to play in encouraging and supporting businesses that voluntarily undertake valid and credible steps to measure, report on and improve their performance in the overlapping areas of corporate governance and responsibility.[70]

6.110 To encourage greater uptake, Dr Longstaff suggested that 'businesses undertaking these commitments should be eligible for 'regulatory relief' – moving from highly prescriptive regimes to a 'principles based' system of co-regulation.'[71] This concept is discussed further in chapter 8 which addresses ways to encourage corporate responsibility.

6.111 The St James Ethics Centre in partnership with the Caux Round Table (CRT) submitted a proposal to introduce the CRT's corporate responsibility risk assessment and behavioural inventory assessment tool, *Arcturus*, to complement the CRI in the Australian market.[72] This tool is intended to engage companies in the voluntary adoption of good governance and corporate responsibility practices, and will assist first time participants to engage voluntarily in corporate responsibility activities such as the CRI. The committee supports further exploration of the *Arcturus* tool.

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68 St James Ethics Centre, *Submission 50*, p. 5.

69 Dr Simon Longstaff, Executive Director, St James Ethics Centre, *Committee Hansard*, 23 November 2005, p. 24.

70 St James Ethics Centre, *Submission 50*, p. 5.

71 St James Ethics Centre, *Submission 50*, p. 5.

72 Joint submission by St James Ethics Centre and Caux Round Table, *Submission 145*, p. 1.

Australian SAM Sustainability Index

6.112 In February 2005, Sustainable Asset Management Australia (SAM) launched the Australian SAM Sustainability Index (AuSSI). To compile the AuSSI a 'corporate sustainability assessment' is conducted to measure and verify the corporate sustainability performance of the Australian companies. The corporate sustainability assessment process invites the largest listed companies in Australia to participate in the assessment. Around 40 to 50 Australian companies participate each year with the remaining companies (approximately 140) being assessed on their publicly available information.

6.113 According to SAM, the AuSSI, which is described as 'corporate Olympics of sustainability',[73] is constructed the in the following manner:

> Each company is allocated a questionnaire accessible in the online database known as the Sustainability Information Management System (SIMS). The questionnaire is composed of approximately 70 to 90 questions which assess the sustainability performance of these Australian companies across three dimensions – economic, environmental and social. The questionnaires focus on leading edge questions that allows the SIMS scoring system to separate leading from laggard companies. Each company is allocated an overall score based on its answers and any additional documentation it provides. The companies are then ranked, in their 21 SAM AuSSI industry sectors, by score order from highest to lowest. ...
>
> The leading 10% of companies in each industry are then chosen as the sustainability leaders for their industry sector. The leaders from each sector are aggregated to form the AuSSI... The AuSSI is reformulated each year with the changes announced in October.[74]

RepuTex SRI Index

6.114 In general terms the RepuTex SRI Index operates in a similar manner and performs a similar function to the AuSSI. Launched in August 2005, the RepuTex SRI Index measures the share market performance of a portfolio of the S&P/ASX300 Index companies listed on the Australian Stock Exchange that demonstrate a required minimum level of socially responsible performance and management of social risk. The RepuTex assessment methodology covers four category areas: Corporate Governance, Environmental Impact, Social Impact and Workplace Practices.

6.115 At its launch, the RepuTex SRI Index comprised 44 companies with a market capitalisation of $427 138 million as at 5 August 2005, representing 52 per cent of the market capitalisation of the S&P/ASX300 Index.

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73 Mr Francis Grey, Research Manager, Sustainable Asset Management Australia, *Committee Hansard*, p. 18.

74 Sustainable Asset Management Australia, *Submission 137*, p. 16.

6.116 The constituent companies are spread across nine Economic Sectors and 14 Industry Groups according to the Global Industry Classification System used for the S&P/ASX300 Index. The major Economic Sector concentration occurs in the Materials, Financials, Industrials and Consumer Staples sectors.

6.117 From the perspective of corporate social responsibility performance, 31 of the 44 companies at launch held a RepuTex rating of 'A', the lowest level of the minimum requirement, whilst seven companies were rated at 'A+', 3 at 'AA-', 2 at 'AA' and 1 at 'AAA'.

State of sustainability reporting in Australia

6.118 In 2005 sustainability reporting was voluntarily undertaken by around 24 per cent of the 500 largest public and private companies operating in Australia.[75] A number of important trends underlie these findings which are detailed in the *State of Sustainability Reporting in Australia 2005* report by the Centre for Australian Ethical Research (the CAER report).

Rate of reporting

6.119 As mentioned in an earlier chapter of this report, corporate Australia lags behind many other developed countries in its rate of sustainability reporting. The CAER report detailed findings from the KPMG's global survey of sustainability reporting practices of June 2005, which found that reporting rates in Australia are lower than in most of the countries surveyed, by percentage of the top 100 publicly listed companies in each country.[76] The average rate across the 16 countries was 41 per cent, compared with 23 per cent in Australia (for the S&P/ASX 100). Countries such as Japan and the United Kingdom have very high rates of sustainability reporting, with 81 and 71 per cent respectively. Australia ranks 14th of the 16 countries surveyed.

6.120 Perhaps not surprisingly given this international comparison, the rate of sustainability reporting by foreign owned companies operating in Australia is more than twice that of Australian owned companies. The average production rate for foreign companies operating in Australia is around 43 per cent, whereas the comparable figure for Australian companies is around 18 per cent.[77]

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75 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 3. The survey was carried out on 500 companies comprised of the S&P/ASX 300 companies, the top 100 unlisted public companies and the top 100 private companies. The results include both stand-alone reports and sustainability sections in annual reports and on reports published in 2004 and 2005.

76 KPMG International, *KPMG International Survey of Corporate Responsibility Reporting 2005*, June 2005.

77 Figures derived from Table 7, Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 28.

6.121 Despite being low by international standards, the rate of sustainability reporting in Australia is increasing rapidly. Data from the CAER report shows strong growth in sustainability reporting by the top 500 companies operating in Australia over the past decade. The recent trends are dominated by an increase in reporting by publicly listed companies. The CAER report speculates that 'the increase over the past year among the S&P/ASX 300 companies may indicate that Australian listed companies are being influenced by the activities overseas and by foreign-owned companies in Australia.'[78] If the current growth rates continue, it could be expected that all of the top 500 companies would be preparing sustainability reports by around 2035.

6.122 The CAER report also identifies a growing trend of companies including a sustainability section in their annual report or on the company's website, although the majority of reports are still issued as stand-alone documents.[79] The use of annual reports to disclose sustainability information is the favoured approach of submitters such as CPA Australia and Professor Deegan.[80]

6.123 Sustainability reporting in Australia is dominated by a number of key sectors including: manufacturing, mining, wholesale trade, finance and utilities. In a number of sectors, no companies have prepared a sustainability report including: hospitalities, health and community services.[81] The CAER report makes special note of the mining and manufacturing sectors, which together account for 55 per cent of sustainability reports, and also the two relevant peak bodies the Plastics and Chemical Industry Association and the Minerals Council of Australia, which both encourage reporting and engagement with sustainability more generally. Chapter 8 highlights some of the important sectoral initiatives that are occurring in Australia.

6.124 According to the CAER report, there has been a dramatic increase in the use of GRI Framework:

> ...[sustainability] reports produced 'in accordance with' the GRI Guidelines increased from five to six, and reports produced 'with reference to' the GRI Guidelines increased from 35 to 61, representing an increase from 30 per cent to 51 per cent of reports using the GRI Guidelines.[82]

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78 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, pp 24–25.

79 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, pp 15 and 21.

80 CPA Australia, *Submission 103A*, p. 2; and Professor Craig Deegan, *Submission 96*, p. 7.

81 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 23.

82 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 4.

6.125 However, as the majority of companies using the GRI Guidelines in Australia are foreign owned, only about 20 per cent of the sustainability reports produced by Australian owned companies are using the GRI, compared with 40 per cent internationally.[83]

Assurance and verification

6.126 Assurance and verification is another area of growing importance in the area of sustainability reporting. The CAER report states:

> [Forty] of the 119 companies producing a sustainability report/section in Australia in 2004 have their report independently verified, representing 34 per cent of reports, an increase from the 28 per cent independently verified last year.[84]

6.127 The auditing of sustainability reports was generally seen by submitters as a positive development in sustainability reporting, improving their accuracy and credibility. However, two main issues were raised. Firstly, the lack of a standardised framework was seen as problematic to the effectiveness of carrying out audits on sustainability reports.[85] Secondly, the financial cost was cited as an impediment to undertaking an audit by 70 per cent of respondents to the CAER report survey.[86]

6.128 However, independent verification was seen as the most effective way for companies to address claims of 'green washed' sustainability reports – that is, reports that painted a company's performance in only a positive light, and in some cases, being silent in relation to negative performance. Results from CPA Australia's *Confidence in Corporate Reporting 2005* survey demonstrate that a perception of green wash is real, with a majority of respondents (54 per cent) agreeing that sustainability reporting is simply a public relations exercise.[87] The same survey found that a large majority (83 per cent) agreed that "companies' social and environmental reporting is only worthwhile if it is subject to independent audit."[88] IAG was one of a number of companies which gave evidence that sustainability reports 'are only

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83 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 41.

84 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 3.

85 Mr Mark Coughlin, National President, CPA Australia, *Committee Hansard*, 23 February 2006, p. 85.

86 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 34.

87 CPA Australia, *Supplementary Submission 103a*, p. 23.

88 CPA Australia, *Supplementary Submission 103a*, p. 23.

worthwhile if you can get that assurance and that assurance comes with a degree of independence.'[89]

Small-to-medium enterprises

6.129 The CAER study found that the uptake rate for smaller corporations is significantly lower. Of the 200 smallest companies in the S&P/ASX 300 around 8 per cent were found to have prepared a sustainability report.[90] This is well below the average for the S&P/ASX 300 of around 18 per cent.[91]

6.130 Many submissions recognised that the impediments, both financial and resource or personnel, faced by small-to-medium enterprises to undertake sustainability reporting are greater than those faced by large corporations. Mr Cooper of ASIC reminded the committee that:

> There are roughly 1.45 million companies in Australia. ASIC's position is that these issues are relevant only to a very small proportion of those companies. It can be very difficult to speak with any coherence about these issues when you are talking about a proprietary company that might own a newsagency and those sorts of businesses, which make up a very large proportion of the corporate landscape.[92]

6.131 The committee also received evidence that if a general corporate responsibility requirement were to be introduced, then it should apply to either all reporting entities or all corporations, not only to large corporations.[93]

Not-for-profit organisations

6.132 The committee received a small amount of evidence regarding the reporting activities of the not-for profit sector. Habitat for Humanity told the committee that their approach was to report in accordance with the ASX Council Recommendations, to demonstrate that they conform to the same governance framework as their major partners, which are typically public corporations.[94]

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89 Ms Sam Mostyn, Group Executive, Culture and Reputation, Insurance Australia Group, *Committee Hansard*, 9 March 2006, p. 8.

90 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 38.

91 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 28.

92 Mr Jeremy Cooper, Deputy Chairman, Australian Securities and Investments Commission, *Committee Hansard,* 29 March 2006, p. 10.

93 For example Mr Daren Armstrong, Secretary, Legislative Review Task Force, Commercial Law Association of Australia Limited, *Committee Hansard*, 23 November 2005, p. 13.

94 Mr Anthony McLellan, Chairman, Habitat for Humanity Australia, *Committee Hansard*, 9 March 2006, p. 27.

6.133 Amnesty International indicated that while they do not undertake triple bottom line reporting, one of their objectives is to 'ensure that we meet standards of reporting that match the reporting requirements we ask of others'.[95]

6.134 Further evidence in relation to the engagement of the not-for-profit sector with the corporate responsibility agenda in the context of their own operations is discussed in chapter 8.

Engaging institutional investors

6.135 In addition to the various aspects of sustainability reporting outlined in the CAER report, one important theme emerged during the course of the inquiry, that is, the lack of engagement of mainstream financial markets.

6.136 An officer of the Department of the Environment and Heritage described the problem as a 'chicken and egg phenomenon' stating:

> ...financial analysts do not often use sustainability information because the data is not in a form that they can use and then companies do not produce sustainability information because the financial analysts are not demanding it.[96]

6.137 Mr Grey from Sustainable Asset Management Research gave a colourful account of the lack of interest and engagement of mainstream financial markets:

> The financial markets are not just not tuned in; they are not turned on—and they are not even plugged in. The radio is not even in the house. It is somewhere else, down at the shop. They have not gone down and bought it yet. They do not know where the shop is and they do not know it exists. If they went past it, they would think it was a baby-wear shop. So they are seriously not involved.[97]

6.138 Mr Grey went on to say that conversely, many company sustainability reports and other sources of non-financial information have failed to convey effectively to investors the ways in which corporate responsibility activities create value for companies.[98]

6.139 A recent study conducted on behalf of the Australian Council of Super Investors also found that despite the dramatic improvement in the rate of sustainability

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95 Amnesty International, *Submission 90a*, response to question on notice, p. 1.

96 Mr Gene McGlynn, Assistant Secretary, Department of the Environment and Heritage, *Committee Hansard*, 27 March 2006, p. 29.

97 Mr Francis Grey, Research Manager and Founding Principal (Australia), Sustainable Asset Management Research, *Committee Hansard*, 5 April 2006, p. 23.

98 Mr Francis Grey, Research Manager and Founding Principal (Australia), Sustainable Asset Management Research, *Committee Hansard*, 5 April 2006, p. 24.

reporting in Australia 'the capacity of superannuation trustees to undertake enhanced analytics is constrained by the lack of information on material CSR risks.'[99]

6.140 Other submitters also commented on the paucity of non-financial information. For example BT Governance Advisory Service (BTGAS) stated:

> The current reporting requirements for publicly listed companies do not give investors sufficient information to understand the extent to which companies are managing social and environmental risks.[100]

6.141 Information provided by BTGAS illustrated how many companies were not disclosing non-financial information (depending on the nature of the business). A high proportion of the top 200 Australian companies:

- did not publicly disclose information on their processes to protect against violations of consumer privacy;
- made no mention of staff or contractor training with regard to product safety or the handling of materials hazardous to public health;
- did not publicly disclose policies protecting whistleblowers; and
- did not publicly disclose their policy and strategy for workplace safety management.[101]

6.142 Treasury officials also agreed with the proposition that if an investor in a company wanted to maximise their return over the long term they would want to know about the company's material sustainability risks. The Treasury representative went on further to say: 'I think you would be worried about investing in a corporation that did not have these risk management plans.'[102]

6.143 What Mr Mather of BTGAS refers to as the 'lack transparency in the interface between companies and markets' can also be described as a form of market failure.[103] Due to a lack of information relating to material non-financial risks (either because companies are choosing not to provide it or investors are not demanding it), the market is not able to attribute a proper corresponding financial value to these risks. As a result, the non-financial risk management activities that companies are undertaking are currently being undervalued by the market; a distinct disincentive to companies considering undertaking corporate responsibility activities. It also means that organisations that have proactively adopted corporate responsibility are not receiving the appropriate level of financial reward for their actions.

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99 The Hon Dr Ken Coghill, Dr Leeora Black, Mr Dough Holmes, *Submission 71*, p. 62.

100 BT Governance Advisory Service, *Submission 19*, p. 8.

101 BT Governance Advisory Service, *Submission 19*, pp 2–3.

102 Mr Matthew Brine, Manager, Governance and Insolvency Unit, Department of the Treasury, *Committee Hansard*, 29 March 2006, p. 18.

103 Mr Erik Mather, Head, BT Governance Advisory Service, *Committee Hansard*, 10 March 2006, p. 67.

Greenhouse and energy reporting

6.144 The committee notes the current consideration being given to a national greenhouse and energy reporting framework through the Joint Environment Protection and Heritage Council / Ministerial Council on Energy Policy Working Group. This initiative of the Council of Australian Governments arises from the regulatory duplication resulting from the large number of government programs which require (or invite) businesses to report their energy use and greenhouse gas emissions to Commonwealth, state or territory agencies.

6.145 Because these programs have nearly all evolved independently they differ greatly with regard to their fundamental approaches, the conditions and thresholds for participation, and types of emissions taken into account.

6.146 Many reporting entities participate in more than one program, with the largest emitters being required to submit as many as seven reports. Multiple reporting increases costs and reduces the value of the reporting effort.[104]

6.147 Joint working groups of Commonwealth and state/territory government officials have developed a proposed national framework for greenhouse and energy reporting that would rationalise data requests from government agencies, cut red tape and reduce business costs. The framework comprises a streamlined data set to reduce duplication of reporting requirements and a national online reporting tool to provide a single submission point for greenhouse and energy data.

6.148 As part of the process, officials are examining both non-mandatory and mandatory options, including the merits, costs and benefits of these different approaches for business, consumers and government.

6.149 Both Ministerial Councils will consider the working groups' recommendations by the end of June 2006. COAG will then consider the Ministerial Councils' finding at its meeting of July 2006.

Committee view

Rate of reporting

6.150 The committee is pleased that the rate of Australian companies reporting is increasing rapidly. The committee notes that this trend is occurring without a mandatory reporting requirement. With some additional support and encouragement from both government and business, the committee believes that this trend will continue into the future. The committee makes several recommendations in this regard in chapter 8.

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104 George Wilkenfeld and Associates, *Costs and Benefits of a National Greenhouse and Energy Reporting Framework*, March 2006, p. 2.

International comparison

6.151 The committee would like to see Australia's rate of sustainability reporting reach the average OECD level. In this regard, Mr Turner reminded the committee of its remarks in 2001 in its report in relation to corporate codes of conduct: that high levels of non-financial disclosure would 'enhance the reputation of Australia's corporations, and for that matter, the reputation of Australia itself.'[105] The committee reiterates this view.

6.152 The committee notes in relation to Australia's comparatively low rate of sustainability reporting that it is important to acknowledge that the reporting rate does not necessarily equate to strong or poor corporate performance. As Professor Newman recognised, 'in many ways there are innovations happening on the ground that have not yet been properly written down or incorporated into ways of thinking and decision making.'[106] The committee also notes the result from CPA Australia's survey which shows that twice as many respondents agree than disagree that 'Australian companies are better corporate citizens than overseas companies.'[107] Conversely, the committee also notes empirical evidence such as that referred to in chapter 7 which shows that Australia significantly lags countries in Europe and the US in terms of the proportion of the largest companies that have stated policies which address bribery and corruption amongst their officials.

Global Reporting Initiative

6.153 The committee is strongly supportive of the Global Reporting Initiative multi-stakeholder process. It acknowledges that it is the most widely accepted international sustainability framework and commends those Australian companies which are active contributors to, and participants in the GRI process. The committee endorses Senator Campbell's comments: 'I am also pleased to note the increased focus on sustainability reporting using standardised formats such as the Global Reporting Initiative (GRI) framework.'[108] The committee makes recommendations regarding the GRI in chapters 7 and 8 of this report.

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105 Mr Richard Turner, *Submission 5*, p. 41, quoting the Parliamentary Joint Statutory Committee on Corporations and Securities, *Report on the Corporate Code of Conduct Bill 2000*, June 2001, p. 1.

106 Professor Peter Newman, Director, Institute of Sustainability and Technology Policy, Murdoch University; Chair, Sustainability Roundtable, Western Australian Government, *Committee Hansard*, 20 February 2006, p. 6.

107 CPA Australia, *Supplementary Submission 103a*, p. 23.

108 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 1.

Disclosures in annual reports

6.154 The committee supports the increasing trend of companies including a sustainability section in their annual reports or on the company's website. In the committee's view this is a cost-effective approach to disclosing sustainability information; will prove more accessible to a greater number of stakeholders; and enables greater comprehensiveness in managing non-financial risks. The trend also suggests that companies are progressively integrating sustainability into their core business activities rather than seeing it as 'side show'.

Assurance and verification

6.155 The committee notes the benefits of applying an assurance and verification process to sustainability reports, especially as such an approach militates against accusations of 'green washing', where reports provide only positive information about a company's activities, and are silent about less-than positive aspects of operations. The committee also recognises, however, that there are significant cost implications of verifying sustainability reports. For reasons similar to those outlined for the continuation of voluntary sustainability reporting, the committee supports the continuation of voluntary assurance and verification of sustainability reports. The committee also supports the development, by appropriate industry bodies, of standard verification techniques relevant to each major sector.

Small-to-medium enterprises

6.156 The committee largely agrees with ASIC's view that sustainability reporting is only relevant to a proportion of Australia's larger businesses. In general larger for-profit and not-for-profit organisations will have greater environmental and social impacts, and a greater capacity to finance these initiatives than smaller organisations.

Lack of material non-financial information

6.157 The committee expresses its concern over the paucity of material non-financial information currently being provided to investors. For financial markets to function effectively and to value properly material non-financial risks, this information must be provided to the market. In chapter 7 of this report the committee recommends a flexible and cost-effective approach to encouraging further disclosure of material non-financial information.

Greenhouse and energy reporting

6.158 A consistent national approach to greenhouse and energy reporting could address the current multiple greenhouse and energy reporting requirements, thereby reducing the cost to business of reporting and increasing its value. A national framework would also provide a basis for more transparent and comparable public disclosure of greenhouse emissions and energy use.

6.159 The committee is of the view that establishment of sectoral benchmarks for greenhouse and energy performance would assist companies to identify areas in which they could improve their non-financial performance. The establishment of these benchmarks should be undertaken by government and industry in collaboration. The committee supports liaison between government and industry to develop a mechanism for setting benchmarks.

Recommendation 6

6.160 The committee recommends that the Australian Government, through the Joint Environment Protection and Heritage Council / Ministerial Council on Energy Policy Working Group process, seek to rationalise Australia's greenhouse and energy reporting requirements into a national framework.

Recommendation 7

6.161 The committee recommends that government and industry should liaise on developing a mechanism for setting sectoral benchmarks for greenhouse and energy performance.

Overseas developments

6.162 Over the last decade, there has been a shift towards greater disclosure by corporations of their non-financial performance. The committee was presented with several interesting examples of overseas developments, several of which were recommended for adoption or rejected in the Australian context.

United States

6.163 In response to corporate collapses such as Enron and WorldCom, the United States legislature introduced new corporate governance disclosure requirements under section 404 of the *Sarbanes-Oxley Act 2002*. Under these new rules, listed companies are required to disclose annually whether they have adopted a code of ethics for the company's CEO, CFO, principal accounting officer or controller, or persons performing similar functions. If it has not, a company will be required to explain why it has not.

6.164 The Sarbanes-Oxley approach has been criticised by both the ASX and ASIC for 'creating a huge compliance burden' and for being extremely costly.[109]

6.165 Listed US companies are also under an obligation to disclosure certain aspects of their environmental performance under Securities and Exchange Commission reporting obligations under Items 101 and 103 of Regulation S-K. Disclosures under both these items are subject to a restrictive materiality test that according to CAMAC:

109 Australian Stock Exchange, *Submission 124*, p. 5; and Mr Jeremy Cooper, Deputy Chairman, Australian Securities and Investments Commission, *Committee Hansard,* 29 March 2006, p. 16.

> ...has in general been interpreted to limit the disclosure obligation to any information that is likely to have an immediate effect on the share price of a corporation. This short-term focus means that the disclosure provisions, outlined below, do not apply to longer term environmental trends or developments affecting corporations.[110]

6.166 Item 303 of Regulation S-K requires disclosures of forward-looking and non-financial information in the form of a management discussion and analysis (MD&A). It is similar to operating and financial review under section 299A of the *Corporations Act 2001* (discussed in chapter 7).

European Union

6.167 Over the past decade various national European Union countries have introduced sustainability-related reporting requirements.

6.168 Mr Turner gave the example of Denmark:

> Denmark mandated public environmental reporting in its 'Green Accounting Law' in 1995, requiring over 3000 Danish companies to publish a 'Green Account' describing their impact on the environment and the way in which they manage this impact. Similar legislation has been enacted in the Netherlands affecting over 300 of the nations largest companies.[111]

6.169 In 2001 the French legislature enacted a disclosure framework for sustainability information as part of the Nouvelles Régulations Économiques (NRE). The NRE requires French listed companies to disclose information with respect to corporate governance, social and community impacts, environmental management and workplace practices, which are set out under nine social and nine environmental indicators. The French requirements go beyond what is required by the EU Accounts Modernisation Directive which is described below.

6.170 The European Union has also been actively pursuing greater disclosure of sustainability information. In June 2003, it adopted *EU Accounts Modernisation Directive* (the Directive) which requires European Community corporations to include certain non-financial information in their annual reports.[112]

6.171 The Directive establishes a 'fair review' requirement for large and medium EU companies to provide the following information in their annual reports. It states:

> The annual report shall include at least a fair review of the development and performance of the company's business and of its position, together with a description of the principal risks and uncertainties that it faces.

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110 Corporations and Markets Advisory Committee, *Corporate Responsibility Discussion Paper*, November 2005, p. 87.

111 Mr Richard Turner, *Submission 5*, p. 37.

112 Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003.

> The review shall be a balanced and comprehensive analysis of the development and performance of the company's business and of its position, consistent with the size and complexity of the business.
>
> To the extent necessary for an understanding of the company's development, performance or position, the analysis shall include both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters.[113]

6.172 The Directive's preamble notes that:

> The information [to be included in the annual report] should not be restricted to the financial aspects of the company's business. It is expected that, where appropriate, this should lead to an analysis of environmental and social aspects necessary for an understanding of the company's development, performance or position.[114]

6.173 The Directive sets minimum mandatory standards, which have been implemented by EU countries such as Germany.

6.174 In the United Kingdom a statutory Operating and Financial Review (OFR) came into force in March 2005, providing a framework for the disclosure of sustainability information. The OFR introduced more rigorous requirements than the Directive in relation to forward-looking information, such as information on strategies and longer term policies. Many submitters recommended that the OFR be adopted as the sustainability reporting framework in Australia. During the course of the inquiry however, the UK Government decided to remove the statutory requirement on listed companies to publish OFRs. In January 2006 the relevant legislation was amended, reverting the OFR to a voluntary mechanism.

6.175 Concurrent with the introduction of the statutory OFR, a 'Business Review', consistent with the Directive was introduced. Despite the repeal of the statutory OFR, the new requirement to include a Business Review in UK Directors' Report remains, thus bringing the UK sustainability reporting requirements in line with the Directive.

6.176 Another recent development that is likely to promote further sustainability reporting in Europe is the announcement in March 2006 of the European Alliance on CSR. The Alliance is a broad partnership between the European Commission and the European business community. According to the communication from the European Commission one of Alliance's three key areas of activities is 'raising awareness and improving knowledge on CSR and reporting on its achievements.'[115] This initiative is discussed further in chapter 8.

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113 Official Journal of the European Union, 17 July 2003, p. L178/18.

114 Official Journal of the European Union, 17 July 2003, p. L178/17.

115 COM(2006)136: European Commission, *Implementing the Partnership for Growth and Jobs: Making Europe a Pole of Excellence on Corporate Social Responsibility*, March 2006, p. 10.

South Africa

6.177 Since September 2003, all companies listed on the Johannesburg Securities Exchange (JSE) must now comply with a *Code of Corporate Practices and Conduct*. The Code requires each entity to issue an annual sustainability report, detailing the nature and extent of its social, transformation, ethical, safety, health and environmental management policies and practices. According to paragraph 5.1.3 of the Code:

> ...disclosure of non financial material [in the report] should be governed by the principles of reliability, relevance, clarity, timeliness and verifiability with reference to the Global Reporting Initiative (GRI) Sustainability Reporting Guidelines.[116]

6.178 In a similar fashion to the ASX Corporate Governance Council's *Principles of Good Corporate Governance and Best Practice Recommendations* (discussed below), the JSE listing rules require annual disclosure of the extent of a listed company's compliance with the Code of Corporate Practices and Conduct and the reasons, where relevant, for non compliance.

Committee view

6.179 In the committee's view there is a range of interesting sustainability reporting developments occurring overseas. Although these initiatives have been designed to suit the particular market requirements and community expectations of each country they may be applicable, to varying degrees, to the composition and circumstances of the Australian market. However given the relatively immature state of evolution of sustainability reporting in Australia, that international models are still being developed, and that some degree of rationalisation may be required amongst the various Australian and overseas reporting frameworks, the committee believes it would be inappropriate and premature to adopt an overseas approach.

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116 The King Committee on Corporate Governance, *Code of Corporate Practices and Conduct*, 2002, p. 16.

CHAPTER 7

SUSTAINABILITY REPORTING: CURRENT LEGISLATIVE AND MARKET REQUIREMENTS

7.1 In Australia, there is no legal requirement for sustainability reporting per se. However there are certain obligations on companies to report both financial and non-financial information in a number of areas. Submitters' views on the appropriateness of current reporting requirements were highly polarised. Corporations and business associations almost unanimously agreed that the current arrangements are appropriate whereas accounting bodies, non-governmental organisations and consultants in general agreed that there is scope for improvement.

7.2 This chapter looks at the existing reporting requirements, for both financial and non-financial information. The financial reporting framework is covered in some detail in the recognition, as some submitters suggested, that existing provisions for disclosure of financial information could be extended to include non-financial information. As Professor Deegan submitted:

> ...there is nothing to preclude the introduction of [non-financial] performance-related disclosures within these sources of regulation...[1]

7.3 Matters discussed in this chapter include:

- Statutory requirements for financial reporting;
- Reporting requirements of the Australian Stock Exchange (ASX) Corporate Governance Council Recommendations;
- The current review of the ASX Corporate Governance Council Recommendations;
- Other ASX requirements; and
- Statutory requirements for non-financial reporting.

Statutory requirements for financial reporting[2]

7.4 Existing statutory requirements for financial reporting are intended to provide structure, comparability and transparency. Some of these requirements are also relevant to sustainability reporting. There are broadly two ways in which listed companies formally disclose information to the market: continuous disclosure and periodic disclosure.

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1 Professor Craig Deegan, *Submission 96*, p. 7.

2 This section is in part based on: Corporations and Markets Advisory Committee, *Corporate Responsibility Discussion Paper*, November 2005; Mr Richard Turner, *Submission 5*; and Professor Craig Deegan, *Submission 96*.

Continuous disclosure

7.5 The regulation governing continuous disclosure is contained in the *Corporations Act 2001* (Corporations Act) and is complemented by the ASX Listing Rules.[3] Under ASX Listing Rule 3.1 listed corporations are required to disclose immediately any information that a reasonable person would expect to have a material effect on the price or value of the entities securities.

7.6 Section 677 of the Corporations Act defines 'material effect on price or value' stating it as information that:

> ...would, or would be likely to, influence persons who commonly invest in securities in deciding whether to acquire or dispose of the [enhanced disclosure] securities.

7.7 Whilst Listing Rule 3.1 is focused primarily on financial issues, it potentially also covers information relating to environmental and social matters that satisfies the materiality test. The ASX Guidance Note on continuous disclosure makes clear that in making continuous disclosures, the listed corporation has an equal duty to shareholders, investors and the market generally.[4] As the interest of institutional investors in corporate responsibility grows, and as the impacts of a company's non-financial performance on overall company value are better understood, this mechanism may become important for disclosures of sustainability information.

7.8 The Australian Human Rights Centre cited the 2003 Ernst & Young report, *The Materiality of Environmental Risk to Australia's Finance Sector* as an indication that materially significant environmental risk is currently under-reported by ASX companies.[5] Mr Spathis of the Australian Council of Super Investors (ACSI) supported this view saying that a recent study conducted by Monash University found that 'information on the material risks was either unavailable or difficult to obtain'.[6] The committee hopes that this trend diminishes as corporations increasingly recognise the importance of non-financial risks to their longer-term financial performance.

7.9 Similar obligations apply to unlisted disclosing entities under the Corporations Act.[7]

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3 *Corporations Act 2001*, ss. 674–678; ASX Listing Rule 3.1.

4 Australian Stock Exchange, *Guidance Note 8: Continuous Disclosure: Listing Rule 3.1*, June 2005, p. 3.

5 Australian Human Rights Centre, *Submission 20*, p. 8.

6 Mr Phillip Spathis, Executive Officer, Australian Council of Super Investors, *Committee Hansard*, 5 April 2006, p. 66.

7 *Corporations Act 2001*, para. 675(1)(b).

Periodic disclosure

7.10 The regulations governing the disclosure of company financial information in annual reports is contained in the *Corporations Act 2001*, Accounting Standards, and Australian Stock Exchange listing requirements (for listed entities).

7.11 All companies (other than some small private companies) and registered managed investment schemes must prepare and file with ASIC an annual report, comprising:

- a financial report; and
- a directors' report.[8]

Financial report

7.12 The Corporations Act prescribes the content of the financial report, including compliance with the accounting standards.[9] Some matters that could be included within a non-financial reporting framework can have direct financial implications. However, there is no requirement that environmental and social aspects of a company's operations be covered in the financial report.[10]

Directors' report – operating and financial review

7.13 The directors' report covers a range of general information concerning the operation of the company, including its principal activities and outcomes during the year, as well as some forward-looking information.[11] Of particular interest is the introduction of an operating and financial review (OFR, also known as the management discussion and analysis, MD&A) contained in section 299A. Under this provision listed companies are required to include in the directors' report any information that shareholders would reasonably require to make an informed assessment of:

- the operations of the company reported on;
- its financial position; and
- the company's business strategies and its prospects for future financial years.

7.14 The OFR obligation aims to ensure greater transparency and accountability within the company's operations and greater opportunity for stakeholders to take an interest in the business operations of the company.

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8 *Corporations Act 2001*, ss. 292–294.

9 *Corporations Act 2001*, ss. 295–297.

10 Corporations and Markets Advisory Committee, *Corporate Responsibility Discussion Paper*, November 2005, p. 80.

11 *Corporations Act 2001*, ss. 298–300A.

7.15 Section 299A was introduced in response to a recommendation in the Royal Commission report *The Failure of HIH Insurance* (April 2003).[12] The Royal Commissioner referred to the proposals in the United Kingdom for an OFR (discussed previously in chapter 6), containing such information that the directors decide is necessary to obtain an understanding of the business, including details of the company's performance, plans, opportunities, corporate governance and management risks.

7.16 Section 299A does not specify the same level of detail as was required in the comprehensive UK OFR provisions, which, for instance, specifically referred to risks and information about the impact of the business on the environment, employees or other interests. Instead, the Explanatory Memorandum to section 299A stated that the provision was intentionally expressed in broad terms:

- to enable directors to make their own assessment of the information needs of shareholders of the company and tailor their disclosures accordingly; and
- to provide flexibility in form and content of the disclosures, as the information needs of shareholders, and the wider capital market, evolve over time.[13]

7.17 The Explanatory Memorandum directs companies to the G100's *Guide to Review of Operations and Financial Condition* (the G100 Guide), which significantly, makes reference to both company stakeholders and the provision of financial and non-financial information. The G100 Guide notes:

> A contemporary Review should include an analysis of industry-wide and company-specific financial and non-financial information that is relevant to an assessment of the company's performance and prospects.[14]

7.18 In various sections, the G100 Guide makes reference to non-financial aspects of business operations including:

> The Review should include a discussion and analysis of *key financial and non-financial performance indicators* (KPIs) used by management in their assessment of the company and its performance … Where practical, KPIs … should include multiple perspectives such as *sustainability measures*

12 See Explanatory Memorandum to Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 para 4.391 and Royal Commission report *The Failure of HIH Insurance*, April 2003, vol 1 at p. 182 and Recommendation 13.

13 Explanatory Memorandum to Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003, para 5.306.

14 Group of 100*, Guide to Review of Operations and Financial Condition*, 2003, p. 7, available at www.group100.com.au/publications/g100_Review_Operations2003.pdf (accessed 10 May 2006).

> *including social and environmental performance measures*, where relevant.[15] [emphasis added]
>
> The Review should provide a commentary on the strengths and resources of the company whose value may not be fully reflected in the statement of financial position … Disclosure of *information about unrecognised intangible assets* such as … *human resources, customer and supplier relationships and innovations* is helpful to users in making decisions.[16] [emphasis added]
>
> The Review should contain discussion of the company's risk profile and risk management practices... All relevant aspects of risk management ... should be discussed. ... The discussion of the risk profile, management and mitigation of risk ... may include:
>
> - Availability of staff and other resources;
> - Occupational health and safety;
> - Environmental issues; and
> - Product liability.[17]

7.19 The Corporations and Markets Advisory Committee noted the potential importance of this development stating:

> The provision applies to annual reports of listed companies from 2005. While potentially a significant development, it will take some time to assess any change in quantity or quality of information reported as a result of the new provision.[18]

7.20 Several corporate representative bodies such as the Australian Bankers Association and the Australian Institute of Company Directors argued that the OFR requirements set out in section 299A provide adequate scope for companies to report their operational and financial performance.[19] In contrast, environmental groups such as the Australian Conservation Foundation argued that it is unlikely that this provision will result in greater disclosure of specific environmental data for most companies.[20]

7.21 The committee is of the view that the OFR in combination with the G100 guide provide an effective mechanism for companies to disclose, and for investors to assess and value, material non-financial performance, risk profile and risk

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15 Group of 100*, Guide to Review of Operations and Financial Condition*, 2003, p. 12.

16 Group of 100*, Guide to Review of Operations and Financial Condition*, 2003, p. 21.

17 Group of 100*, Guide to Review of Operations and Financial Condition*, 2003, p. 22.

18 Corporations and Markets Advisory Committee, *Corporate Responsibility Discussion Paper*, November 2005, p. 83.

19 Australian Bankers Association, *Submission 106*, p. 16; Australian Institute of Company Directors, *Submission 73*, p. 17.

20 Australian Conservation Foundation, *Submission 21*, p. 32.

management strategies. The committee believes that the non-financial disclosures that result from this new mechanism should be closely monitored by company auditors to ensure that disclosures are meeting the evolving needs of shareholders and the wider capital market.

Recommendation 8

7.22 The committee recommends that each company auditor on an annual basis:

- **review the extent to which companies are making non-financial disclosures in their Operating and Financial Reviews; and**
- **make recommendations to the company Board regarding the adequacy of the disclosures to meet the evolving needs of shareholders, and the wider capital market in order to assess and value material non financial performance, risk profile and risk management strategies.**

Requirements of the Corporate Governance Council Recommendations

7.23 In response to a number of high-profile corporate collapses which occurred in Australia and overseas throughout 2001 and 2002, the ASX Corporate Governance Council released its *Principles of Good Corporate Governance and Best Practice Recommendations* (the ASX Council Recommendations).[21] ASX Listing Rule 4.10.3 requires companies to provide a statement in their annual report disclosing the extent to which they have followed the 28 ASX Council Recommendations, which are framed under ten Principles of Good Corporate Governance. The ASX Council Recommendations are said to be neither mandatory nor prescriptive. They point out that '[i]f a company considers that a recommendation is inappropriate to its particular circumstances, it has the flexibility not to adopt it – a flexibility tempered by the requirement to explain why.'[22] Where companies have not followed a recommendation, they must give reasons for taking an alternative approach. This is referred to as the 'if not, why not' obligation.

7.24 During the inquiry the Chair of the ASX Corporate Governance Council, Mr Eric Mayne was asked whether he thought the 'if not, why not' mechanism has the practical effect of making the ASX Council Recommendations quasi-mandatory. Mr Mayne acknowledged that companies tend to regard them as 'somewhat prescriptive' because the recommendations essentially set a framework for companies'

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21 In this regard the Committee notes the comments of CPA Australia: 'Over recent years Australian business, government and community have witnessed some unacceptable corporate conduct. Each incident reinforces a growing disconnect between the expectations of community and the practices of some corporations. However, each incident also serves to emphasise that inappropriate practices are not the norm, and the vast majority of today's business leaders regularly display high levels of competence and integrity.' (CPA Australia, *Submission* 103, p. 3).

22 ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 5.

responses. However, Mr Mayne agreed that in disclosing information about corporate governance practices, companies are responding to market expectations and that market forces should dictate how companies respond.[23]

7.25 The results from the ASX's recently released review of disclosures in 2005 annual reports (discussed below) suggest that companies don't see the ASX Council Recommendations as prescriptive, as 26 per cent of the market chose not to adopt the recommendations or adopted an alternative practice.[24]

7.26 Despite being criticised as a 'lost opportunity'[25] and 'benign in many ways'[26] the ASX Council Recommendations were generally viewed as a positive mechanism to encourage listed companies to improve their corporate governance practices. Corporate ResponseAbility described their strength as giving 'both a high level overview and clear direction without being overly prescriptive.'[27]

7.27 Although the ASX Council Recommendations are specifically designed to encourage improved corporate governance practices, three of the ten principles contained in the ASX Council Recommendations are directly relevant to the disclosure of sustainability information. These are:

- Principle 3: Promote ethical and responsible decision-making;
- Principle 7: Recognise and manage risk; and
- Principle 10: Recognise the legitimate interests of stakeholders.

Principle 3: Promote ethical and responsible decision-making

7.28 As discussed in chapter 6, ASX Council Recommendation 3.1 creates an expectation for publicly listed entities to establish a code of conduct to actively promote ethical and responsible decision making. The ASX Council Recommendations state 'investor confidence can be enhanced if the company clearly articulates the practices by which it intends directors and key executives to abide.'[28] Depending on the content of the code of conduct, the confidence other company stakeholders have in the company could also be enhanced. For example the

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23 Mr Eric Mayne, Chair, Australian Stock Exchange Corporate Governance Council, *Committee Hansard*, 10 March 2006, p. 6.

24 Australian Stock Exchange, *Analysis of Corporate Governance Practices reported in 2005 Annual Reports*, May 2006, p. 2, available at http://www.asx.com.au/about/pdf/corporate_governance_2005_disclosure.pdf (accessed 23 May 2006).

25 Professor Craig Deegan, *Submission 96*, p. 15.

26 Mr Tim Sheehy, Chief Executive, Chartered Secretaries Australia, *Committee Hansard*, 23 November 2005, p. 50.

27 Corporate ResponseAbility, *Submission 93*, p. 5.

28 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 25.

ASX Council Recommendations suggest that the code of conduct could include 'fair dealing by all employees with the company's customers, suppliers, competitors and employees' which would obviously provide these stakeholders with a degree of enhanced confidence.

Principle 7: Recognise and manage risk

7.29 Of all the principles, Principle 7 is perhaps the most closely aligned with one of the key characteristics of corporate responsibility – risk management. Principle 7 refers to listed companies establishing 'a sound system of risk oversight and management and internal control' designed to:

- identify, assess, monitor and manage risk; and
- inform investors of material changes to the company's risk profile.

7.30 In order to satisfy this principle, Recommendation 7.1 specifies that the board or appropriate board committee should establish policies on risk oversight and management.

7.31 According to the guidance on Recommendation 7.1 the policies should include a risk profile component, which 'should be a description of the material risks facing the company. *Material risks include financial and non-financial matters*.'[29] [emphasis added]

7.32 The guidance to Principle 7 goes on to state that a description of the company's risk management policy and internal compliance and control system should be made publicly available, ideally by posting it to the company's website in a clearly marked corporate governance section.[30]

7.33 Recommendation 7.2 is also potentially relevant to a company's management of non-financial risks. It states that:

> The chief executive officer (or equivalent) and the chief financial officer (or equivalent) should state to the board in writing that ... the company's risk management and internal compliance and control system is operating efficiently and effectively in all material respects.[31]

7.34 The requirement set out in this Principle is for the disclosure of material risks, be they financial or non-financial. The question of materiality is by its nature a subjective one. As a result, whether companies disclose information on non-financial risks under this Principle will depend on whether it is seen as material by each

29 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 44.

30 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 45.

31 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 45.

individual organisation. Despite this uncertainty, this Principle is clearly relevant to the concept of corporate responsibility.

Principle 10: Recognise the legitimate interests of stakeholders

7.35 This Principle refers to listed companies establishing and disclosing a code of conduct to guide compliance with their legal and other obligations to legitimate stakeholders. It sets out various suggestions for matters to be covered by that code of conduct.

7.36 Guidelines for the content of the code of conduct are provided and include reference to:

- Responsibilities to clients, customers and consumers;
- Employment practices – such as occupational health and safety; special entitlements above the statutory minimum; training and further education support; and prohibitions on the offering and acceptance of bribes;
- Responsibilities to the community – this might include environmental protection policies, support for community activities, donation or sponsorship policies; and
- How the company complies with legislation affecting its operations – for example for companies that operate outside Australia, whether those operations comply with Australian or local legal requirements.

7.37 Principle 10 requires listed companies to publish (ideally in a clearly marked corporate governance section on their website) a description of any applicable code of conduct or a summary of its main provisions. They should also include within their annual report an explanation of any departure from the best practice recommendation in Principle 10.

7.38 2004 was the first year that listed companies were required to provide disclosure against the ASX Council Recommendations. In May 2005 the ASX released a report on the corporate governance disclosures reported in 2004 annual reports. This report indicates that the average adoption rate for all ASX Council Recommendations for the whole market was 68 per cent and almost 85 per cent for the top-500 companies.[32] The NSW Young Lawyers observed that 'this indicates a clear acceptance of the principles at the board-room level.'[33]

32 ASX Corporate Governance Council, *Analysis of Corporate Governance Practices reported in 2004 Annual Reports*, May 2005, p. 3.

33 New South Wales Young Lawyers Pro Bono and Community Services Taskforce, *Submission 65*, p. 18.

7.39 The updated 2005 report was recently released by the ASX, and this report indicates an improved trend in overall adoption of the ASX Council Recommendations.[34]

7.40 During the course of the inquiry, adaptation of the ASX Council Recommendations was often referred to as a possible option for encouraging a greater level of sustainability reporting in Australia. Options for adaptation are discussed below.

Review of the Corporate Governance Council Recommendations[35]

7.41 In September 2005, Senator the Hon Ian Campbell, Minister for the Environment and Heritage, asked the ASX Corporate Governance Council to consider the development of a voluntary reporting framework for sustainability reporting. Recognising that reporting against a standardised framework would increase comparability and make reports more relevant to business and other stakeholders, the Minister asked the Council to consider options on how to enhance comparability. In particular, the Minister recommended consideration of an agreed reporting framework using an 'if not, why not' approach to allow for greater comparability, whilst maintaining the principle of voluntary sustainability reporting.

7.42 Following the request by Senator Campbell, the ASX Corporate Governance Council set up a working group to consider how best to encourage greater non-financial reporting.

7.43 The working group reported to ASX Corporate Governance Council in December 2005. To capture industry views the ASX Corporate Governance Council has agreed to prepare a consultation document which will address:

- What corporate responsibility means;
- Which companies it should apply to;
- Which aspects should be left to the market (i.e. voluntary disclosure) and which aspects should be suggested or mandated (i.e. what the reporting framework should be); and
- What the benefits to investors and the community and the markets will be and whether those benefits outweigh additional compliance costs.[36]

7.44 During his appearance before the committee Mr Mayne indicated four possible options to enhance the ASX Council Recommendations in response to Senator Campbell's request:

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34 ASX Corporate Governance Council, *2005 Analysis of Corporate Governance Practice Disclosure*, May 2006, p. 2.

35 The section utilises information provided by the Australian Stock Exchange, *Submission 124*, and the Department of the Environment and Heritage, *Submission 116*.

36 Australian Stock Exchange, *Submission 124*, p. 6.

- A voluntary, standardised reporting framework such as the GRI;
- Providing further guidance;
- Providing further guidance and the inclusion of a reporting trigger; and
- Await the findings of the Parliamentary Joint Committee on Corporations and Financial Services as well as the report from the Corporations and Markets Advisory Committee.[37]

7.45 Mr Mayne elaborated on all four options, which are discussed in more detail below.

Option 1: Incorporate a standardised framework

7.46 On the first option, to incorporate a standardised framework such as the GRI, Mr Mayne acknowledged the advantages of a standardised reporting framework, such as providing structure, rigour and comparability to sustainability reports, and highlighted a range of concerns including the diversity of the market, the potential for greenwash, and the possibility that it would become a prescriptive framework.[38]

7.47 The majority of submitters that favour enhancing the non-financial disclosure requirements under the ASX Council Recommendations preferred this option, although there was disagreement on which framework should be adopted. For example, KPMG suggest that the ASX Corporate Governance Council should be encouraged to include sustainability reporting in the ASX Council Recommendations and that an Australian framework for sustainability reporting be established that is consistent with international requirements such as the GRI for use by those reporting entities which elect to issue sustainability reports.[39]

7.48 As an alternative the Ethical Investment Association recommended the inclusion of a United Kingdom style OFR as the standardised framework under the ASX Council Recommendations. Mr Turner suggested that draft guidelines for environmental and social reporting from the Department of Environment and Heritage (DEH) and Department of Family and Community Services and Indigenous Affairs (FaCSIA) be used. The Public Law Clearing House recommended the inclusion of a

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37 Mr Eric Mayne, Chair, Australian Stock Exchange Corporate Governance Council, *Committee Hansard*, 10 March 2006, p. 5.

38 Mr Eric Mayne, Chair, Australian Stock Exchange Corporate Governance Council, *Committee Hansard*, 10 March 2006, p. 9.

39 Mr Michael Bray, Partner, KPMG, *Committee Hansard*, 24 February 2006, pp 37–38.

disclosure framework referable to universal standards of assessing corporate conduct, presumably an instrument such as the UN Global Compact.[40]

7.49 Mr Mayne threw some doubt on this option by saying:

> The council working group that has been looking at this particular option, I think it is fair to say, probably does not favour that as the option that should go forward.[41]

Committee view

7.50 The committee notes that this view of the Council working group may be somewhat premature, given that it is a view formed prior to the release of the Council's industry consultation paper. The committee supports greater comparability of sustainability information from the perspective of:

- financial markets, in terms of valuing non-financial risk management performance;
- corporations, for the purpose of benchmarking best practice; and
- public interest, for the purpose of corporate transparency.

7.51 A lack of comparability undermines the utility of sustainability reporting and also reduces public confidence in the considerable corporate responsibility activities that Australian companies are pursuing. Over time the absence of a standardised sustainability reporting framework will raise questions over the genuine commitment of Australian corporations in this area.

7.52 The committee also believes that the 'if not, why not' model of the ASX Council Recommendations provides sufficient flexibility for those corporations which choose to undertake sustainability reporting, but which also wish to use an alternative framework. Furthermore, the committee notes the inherent flexibility built into a standardised framework such as the GRI, allowing companies to tailor the reporting structure to suit their own needs. For these reasons the committee strongly supports Senator Campbell's referral to the ASX Corporate Governance Council, and encourages the Council to consider fully the development of a voluntary reporting framework for sustainability reporting.

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40 Ethical Investment Association, *Submission 105*, p. 4; Mr Richard Turner, *Submission 5*, p. 50; and Public Law Clearing House (Vic) Inc, *Submission 66*, p. 14, respectively. Other submissions that suggested including a reporting framework in the ASX Council Recommendations, without specifying a preferred framework included the Governance and Corporate Social Responsibility Research Unit, Curtin Business School, Curtin University of Technology, *Submission 128a*, p. 3; Professor Bryan Horrigan, *Submission 14*, p. 7; and Volunteering Australia, *Submission 36*, p. 5.

41 Mr Eric Mayne, Chair, Australian Stock Exchange Corporate Governance Council, *Committee Hansard*, 10 March 2006, p. 9.

7.53 Despite the committee's strong support for a voluntary sustainability reporting framework and the widespread acceptance of the GRI as the emerging international standard for sustainability reporting, the committee believes that it is too early to recommend the GRI as the voluntary Australian standard. The diversity of opinion over the appropriate framework for inclusion in the ASX Council Recommendations demonstrates that there remains uncertainty as to which framework is preferable to suit Australian market conditions. It is also prudent prior to nominating the GRI as the Australian standard, to consider the Australian sustainability framework currently under development by CPA Australia and the University of Sydney.

7.54 It is worth noting however that the *State of Sustainability Reporting in Australia 2005* shows a clear trend for Australian based companies to report 'with reference' to the GRI Framework.[42] If this trend continues, Australian corporations will become more familiar and comfortable with the GRI Framework, particularly once Australian organisations gain experience with the revised and improved G3, and the Australian Government should reconsider the suitability of the GRI as the Australian sustainability reporting standard.

Recommendation 9

7.55 The committee recommends that:

- **it is premature to adopt the Global Reporting Initiative Framework as the voluntary Australian sustainability reporting framework; and**
- **that the Australian Government continue to monitor the acceptance and uptake of the Global Reporting Initiative Framework, both nationally and internationally, with a view to its suitability as the, or a basis for a, voluntary Australian sustainability reporting framework.**

7.56 Despite not recommending the GRI Framework as the voluntary Australian standard, the committee believes there is value in promoting its greater acceptance and uptake in Australia. In chapter 8 the committee makes a recommendation to promote the GRI Framework to Australian corporations including small to medium enterprises.

Option 2: Provide further guidance

7.57 On the second option, to provide further guidance on the existing ASX Council Recommendations, Mr Mayne noted the merit of this approach in giving greater clarity to the listed entities, but acknowledged that it would be a temporary one to two year arrangement depending on company take-up.[43] It can be inferred from Mr Mayne's remarks that if, after one or two years, companies were not using the additional guidance to improve their non-financial disclosures, then more detailed

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42 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 4.

43 Mr Eric Mayne, Chair, Australian Stock Exchange Corporate Governance Council, *Committee Hansard*, 10 March 2006, p. 9.

requirements would be necessary. Submitters preferring a less structured approach, such as the Australian Institute of Company Directors, favoured this option.[44]

7.58 The need for clearer guidance was illustrated by the fact that despite the reasonably strong adoption rate of the ASX Council Recommendations, several submitters questioned the adequacy of the content of disclosures. For instance RepuTex submitted:

> ...compliance [with the ASX Council's Recommendations] may be deemed adequate even if it amounts to merely a brief sentence or paragraph. This is not the desired outcome of the [ASX Council Recommendations], which are deliberately flexible to reflect the diverse nature of Australian companies.[45]

7.59 Several specific subject areas were brought to the committee's attention which may warrant further guidance in the ASX Council Recommendations. For instance the committee was referred to a report by the Centre for Australian Ethical Research, entitled *Just how business is done? A review of Australian business' approach to bribery and corruption*.[46] The report found that 51 per cent of the ASX 100 companies have stated policies which address bribery and corruption amongst their officials, which compares with 92 per cent in the UK, 80 per cent in the US and 91 per cent in Europe. The report suggests that 'the ASX does not currently suggest corruption as an issue for inclusion in a business ethics codes.'[47]

7.60 Two organisations representing or advising institutional investors also raised concerns over the adequacy of disclosures. Evidence from Mr Spathis of ACSI demonstrates that, although the ASX Council Recommendations are a step in the right direction:

> The anecdotal feedback I am getting from our and other representatives on the ASX Corporate Governance Council is that the feedback from corporations on principle 7 has been pretty light on.[48]

7.61 These concerns were echoed by BTGAS which submitted that there needs to be greater consideration of the responses companies give under Principles 7 and 10.[49]

7.62 BTGAS provided several compelling examples which clearly illustrate why certain non-financial risks are becoming so important to both institutional investors

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44 Australian Institute of Company Directors, *Submission 73*, p. 17.

45 RepuTex Ratings & Research Services, *Submission 86*, p. 16.

46 Dr Judy Henderson, Global Reporting Initiative, *Committee Hansard*, 10 March 2006, p. 27.

47 Centre for Australian Ethical Research, *Just how business is done? A review of Australian business' approach to bribery and corruption*, March 2006, p. 3.

48 Mr Phillip Spathis, Executive Officer, Australian Council of Super Investors, *Committee Hansard*, 5 April 2006, p. 67.

49 BT Governance Advisory Service, *Submission 19*, p. 5.

and to companies' longer term financial position. For instance it submitted that Australian work-related injuries are estimated to cost Australian companies $27 billion per annum, with indirect costs potentially up to four times greater. In relation to energy and greenhouse risks BTGAS cited analysis by the Carbon Disclosure Project which indicates that a five per cent increase in energy prices could impact per share earnings by as much as 15 per cent in certain industries.[50]

7.63 Finally, the ASX Corporate Governance Council's recently released review of 2005 corporate governance disclosures seems to confirm that the sustainability information being provided to the market is ad hoc and inconsistent. The report found deficiencies in relation to Principle 7 disclosures, stating 'while many companies referred to responsibility for risk management ... fewer companies actually reported on the policies in place or disclosed a description of these policies.'[51]

7.64 The report's sustainability and corporate responsibility section also demonstrates that some companies do not have a full understanding of what is expected in the disclosures they make. For instance, sustainability and corporate responsibility disclosures were not necessarily made in the context of a specific principle. Where companies did refer to a Principle they referred to Principles 1, 3, 4, 7 and 10 or a combination of these Principles.[52] This suggests that further guidance is required regarding the disclosure of non-financial information. This is particularly true given the ASX Corporate Governance Council's view that 'meeting the information needs of a modern investment community is also paramount in terms of accountability and attracting capital.'[53]

7.65 ACSI put forward a proposal to encourage corporations to disclose a level of non-financial performance information that is material to their long term financial performance. Essentially the proposal is for companies to self-identify the non-financial risks that are of greatest importance to the organisation. ACSI suggest that corporations should self-identify their top five sustainability risks and the strategies and mechanisms planned, or in place, to manage them. Ms McCluskey of the fund manager Portfolio Partners, who appeared before the committee with ACSI, noted that BHP Billiton had used this approach in its 2004 *Health Safety Environment*

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50 BT Governance Advisory Service, *Submission 19*, p. 8.

51 ASX Corporate Governance Council, *2005 Analysis of corporate governance practice disclosure*, May 2006, p. 12.

52 ASX Corporate Governance Council, *2005 Analysis of corporate governance practice disclosure*, May 2006, p. 13.

53 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 3.

and Community Report, which was 'very effective'.[54] By comparison with BHP Billiton's annual report disclosure in response to the Principle 7, the top five sustainability risk disclosure is far more user friendly and informative.

Committee view

7.66 The committee concluded that only limited non-financial performance information is being provided to the market. This is a particular concern of institutional investors which as discussed in chapter 5 have an obligation to consider long term risks, such as those posed by environmental and social risks. Given the apparent inadequacy of non-financial disclosures that are currently being made under Principles 3, 7 and 10, the committee believes that it is appropriate to provide further guidance and clarity regarding the extent of non-financial information expected.

7.67 In the committee's view the ASX Corporate Governance Council should provide further guidance on Recommendation 7.1 regarding how companies should achieve the non-financial aspect of the 'risk profile' component of the 'policies on risk oversight and management'.[55] In particular, an ASX Guidance Note should clearly articulate that companies should inform investors of material non-financial aspects of the company's risk profile by disclosing their top five sustainability risks, as well as the associated management strategies in the 'risk management' section.

7.68 The benefit of this approach is that it would provide companies with a large degree of flexibility as they would be able to self-identify the most appropriate sustainability risks for their business. This flexibility would be coupled with the inherent flexibility of the 'if not, why not' formulation of the ASX Council Recommendations. It would provide investors with an indication of a company's major non-financial risks and the strategies being pursued to manage, minimise or take advantage of those risks.

7.69 The ASX Corporate Governance Council should also use its discussion paper as a mechanism to consult with companies, investors and other stakeholders regarding other areas where greater clarification and guidance is required under Principles 3, 7 and 10 in relation to non-financial performance, risks and management.

Recommendation 10

7.70 The committee recommends that the Australian Stock Exchange Corporate Governance Council (ASX Council) provide further guidance to

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54 Ms Amanda McCluskey, Sustainability Manager, Portfolio Partners, *Committee Hansard*, 5 April 2006, p. 69. BHP Billiton's *Health Safety Environment and Community Report 2004* is available from www.bhpbilliton.com.au/bbContentRepository/Reports/bhpb_full_hsec_report_04.pdf, pp 16-20 (accessed 10 May 2006).

55 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 44.

Principle 7 of the ASX Council's *Principles of Good Corporate Governance and Best Practice Recommendations* to the effect that companies should inform investors of the material non-financial aspects of a company's risk profile by disclosing their top five sustainability risks (unless they demonstrate having fewer); and providing information on the strategies to manage such risks.

Recommendation 11

7.71 The committee recommends that the ASX Council undertake industry consultation to determine whether there are areas where companies, investors, and other stakeholders believe further guidance is necessary in relation to the non-financial disclosure requirements under the ASX Council's *Principles of Good Corporate Governance and Best Practice Recommendations.*

7.72 In recommending that the ASX Council formulates further guidance, the committee highlights what it sees as an important consideration in providing such information that is its accessibility and utility to financial markets. If non-financial disclosures are to be relevant to financial analysts they must be in a form that is readily accessible. The committee heard evidence that 'corporate Australia is being run by an Excel spreadsheet.'[56] These sorts of considerations should be taken into account so that material disclosures of sustainability risks are as effective as possible.

7.73 In recognition that it is not only the disclosure of material non-financial information that is leading to undervaluation of sustainability risks, but also the way it is used, the following chapter discusses this issue and sets out a complementary recommendation to raise awareness amongst investors of material sustainability risks.

7.74 In relation to the specific bribery and corruption example mentioned above, the committee notes that the ASX Council Recommendations already suggests that, in relation to employment practices, a company code of conduct 'might include reference to ... prohibitions on the offering and acceptance of bribes'.[57] Given the recent publicity in this area, it may be appropriate for the ASX Corporate Governance Council to elaborate further on what is expected.

Option 3: Further guidance plus a reporting trigger

7.75 The third option being considered by the ASX Council as advised by Mr Mayne is to include further guidance within the Principles, and in addition to require a reporting trigger. The committee interpreted this trigger to imply the inclusion of a new recommendation within the ASX Council Recommendations for companies of a certain size or ranking to disclose publicly sustainability information.

56 Mr Erik Mather, Head, BT Governance Advisory Service, *Committee Hansard*, 10 March 2006, pp 68–69.

57 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 60.

7.76 In relation to this proposal, Mr Mayne indicated that 'it may well be too soon to embark upon that area' and that it would depend on feedback from the discussion paper.[58]

7.77 Regarding this option the committee notes two broad categories of recommendation it received. These were:

- full sustainability reporting; and
- a minimum benchmark approach.

7.78 Full sustainability reporting was advocated by a number of submitters, either in the context of the ASX Council Recommendations or as a requirement under the Corporations Act.[59] Various submitters including most corporations and industry bodies opposed full sustainability reporting.[60]

7.79 This option differs from Mr Mayne's first option in that, in the case of the ASX Council Recommendations, it would specify an 'if not, why not' requirement for sustainability reporting rather than specifying a sustainability reporting framework for companies that voluntarily chose to report.

7.80 The general thrust of a minimum benchmark approach is for companies, within an overall voluntary sustainability reporting framework, to disclose a minimum level of non-financial performance information that is vital to companies' long-term financial performance. Within the ASX Council Recommendations such an approach would have the flexibility inherent in its 'if not, why not' model.

7.81 This approach was advocated by organisations such as AMP Capital Investors Sustainable Funds, which proposed the following four specific key performance indicators as minimum non-financial performance indicators: non-compliance with law; occupational health and safety performance; greenhouse gas emissions; and political donations.[61] Mr Berger of the Australian Conservation Foundation added a potential option to streamline this concept when he suggested 'a minimum threshold

58 Mr Eric Mayne, Chair, Australian Stock Exchange Corporate Governance Council, *Committee Hansard*, 10 March 2006, pp 9–10.

59 For example the Australian Conservation Foundation, *Submission 21*, p. 34; Oxfam, *Submission 45*, p. 6; KPMG, *Submission 53*, p. 7; Australian Centre for Corporate Social Responsibility, *Submission 63*, pp 5–6; Gippsland Community Legal Service, *Submission 79*, p. 8; Professor Craig Deegan, *Submission 96*, p. 5; Dr Sean Cooney, *Submission 104*, p. 2; Ethical Investment Association, *Submission 105*, p. 4; and Futureye, *Submission 119*, p. 9.

60 For example Philanthropy Australia, *Submission 23*, p. 14; Australian Institute of Company Directors, *Submission 73*, p. 4; Shell Australia, *Submission 74*, p. 11; Credit Union Services Corporation (Australia) Limited, *Submission 77*, p. 3; Business Council of Australia, *Submission 108*, p. 51; British American Tobacco Australia, *Submission 112*, p. 5; and Mr Alex Gosman, Director, Government and Corporate Affairs, GlaxoSmithKline, *Committee Hansard*, 23 February 2006, p. 44.

61 AMP Capital Investors Sustainable Funds, *Submission 30*, pp 1–2.

so that companies such as investment vehicles that have trivial or negligible [greenhouse] impacts are exempt from those reporting requirements.'[62]

Committee view

7.82 The committee does not favour a full sustainability reporting approach. It has the potential to become a requirement that promotes form over substance. The committee believes that it is vitally important for companies to be encouraged strongly to engage voluntarily in sustainability reporting rather than being forced to do so. The committee heard evidence from several of Australia's leading performers in the area of corporate responsibility (such as Insurance Australia Group and ANZ Bank) of the significant shift in an organisation's culture which is required to integrate fully the concept of sustainability into its core business practices and structures. Imposing a sustainability reporting requirement, even with the inherent flexibility of the 'if not, why not' framework, could force those Australian companies which to date have not fully engaged in the corporate responsibility debate, into a knee-jerk and ill-considered attempt to comply with a sustainability reporting requirement. This would result in such companies developing a piecemeal and minimalist approach, rather than integrating the concept of corporate responsibility into the corporation's core operations and activities in a manner that best suits the company and its stakeholders. In the committee's view a well thought through and integrated approach that has sufficient time to develop properly will be far more effective than one that is forced on companies. The committee is also concerned to ensure that any approach is cost-effective for Australian business, particularly smaller listed companies.

7.83 The committee is more favourably disposed to a minimum benchmark approach. The committee acknowledges the legitimate need of a growing number of institutional investors and fund managers to have access to information regarding non-financial risks and company management strategies to deal with those risks.

7.84 On balance however, the committee is of the view that the minimum benchmark approach is more rigid and inflexible than the approach whereby companies are able to self-identify relevant risks. The committee notes that although major non-financial risks may be common within industry sectors (for example OH&S and energy use within the mining sector), because different industry sectors will typically have different major non-financial risks, a minimum benchmark approach may need to be varied according to the industry sector. There already exist a number of regulatory and market-based mechanisms by which companies, if the market dictates, are able to disclose such additional non-financial information. These include the Operating and Financial Review (section 299A of the Corporations Act), and the Review of Operations and Activities (ASX Listing Rule 4.10.17 discussed below). As investors and other stakeholders demand more non-financial information,

62 Mr Charles Berger, Legal Adviser, Australian Conservation Foundation, *Committee Hansard*, 24 February 2006, p. 83.

the ASX could consider options to enhance the non-financial disclosure aspects of the Review of Operations and Activities or the ASX Council Recommendations.

Option 4: Await inquiry recommendations

7.85 On the fourth option, to await the recommendations of both this committee and the CAMAC, Mr Mayne commented that 'I suspect that that is probably not an option that we would embark upon.'[63]

Committee view

7.86 The committee believes that this option is an internal matter for the ASX Corporate Governance Council to determine. The committee expects the ASX to take account of this report and to refer to the helpful submissions to this inquiry.[64]

Other Australian Stock Exchange requirements

7.87 Apart from the requirements under the ASX Council Recommendations, ASX Listing Rule 4.10.17, which relates to the Review of Operations and Activities, is relevant to sustainability reporting.

7.88 This listing rule is based on section 299 of the Corporations Act. The guidance note to that Listing Rule states that, while the ASX does not require the review to follow any particular format, it supports the Group of 100 publication, *Guide to the Review of Operations and Financial Condition* (the G100 Guide).

7.89 The G100 Guide, which is reproduced in Guidance Note 10 of the ASX Listing Rules, makes clear that there is scope within the existing ASX Listing requirements for social and environmental information to be provided within the Review of Operations and Activities, with specific reference to the associated risks.

Non-financial reporting

7.90 Many submissions pointed to two existing requirements within the Corporations Act for the disclosure of specific non-financial information.

Paragraph 299(1)(f)

7.91 Paragraph 299(1)(f) of the Corporations Act requires disclosure of details of a company's performance in relation to any significant Commonwealth, state or territory environmental regulation that the company's operations are subject to. This mandatory

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63 Mr Eric Mayne, Chair, Australian Stock Exchange Corporate Governance Council, *Committee Hansard*, 10 March 2006, p. 10.

64 Submissions are available on the committee's website at www.aph.gov.au/senate/committee/corporations_ctte/corporate_responsibility/index.htm

requirement applies to all entities that are required to prepare financial statements under the Corporations Act.

7.92 The Australian Human Rights Centre referred to studies which indicate that the introduction of paragraph 299(1)(f) significantly improved overall reporting by Australian companies on their environmental performance.[65]

7.93 On the other hand there was criticism of the value of this provision, both in relation to informing investors, and in terms of its overall effectiveness. For example its was submitted that paragraph 299(1)(f):

> ...doesn't allow investors to fully understand or price risk derived from companies and directors who fail to adequately internalise potential costs of breaches of environmental law. Hence, unless the breach is financially material, there is little incentive for analysts to price the risk into the valuation model. Meanwhile, the environmental damage has occurred and there is little ongoing incentive to redress or alter internal (company) risk management procedures (such as a formal environmental management system).[66]

7.94 The Australian Conservation Foundation was also critical of this provision saying:

> ...it is so ridden with qualifications that most companies provide no meaningful information, even when they have breached environmental laws during the relevant period. Companies also commonly read a 'materiality' qualification into the clause, which eviscerates it.[67]

7.95 ASIC also raised doubts about the effectiveness of paragraph 299(1)(f). Mr Cooper said that the provision did not encourage more of the resources sector to report more broadly on sustainability issues and that global forces are much more important in this regard.[68]

Paragraph 1013D(1)(l)

7.96 The other provision in the Corporations Act that requires disclosure of specific non-financial information is paragraph 1013D(1)(l). This provision requires issuers of investment products (such as superannuation products, managed investment products and investment life insurance products) to include in a Product Disclosure Statement 'the extent to which labour standards or environmental, social or ethical considerations are taken into account in the selection, retention or realisation of the

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65 Australian Human Right Centre, *Submission 20*, p. 9.

66 United Nations Environment Programme Finance Initiative Australasian Operational Environmental Management and Reporting Advisory Committee, *Submission 127*, p. 4.

67 Australian Conservation Foundation, *Submission 21*, p. 31.

68 Mr Jeremy Cooper, Deputy Chairman, Australian Securities and Investments Commission, *Committee Hansard,* 29 March 2006, p. 23.

investment.' The provision applies specifically to investment products and is not a general requirement for the disclosure of non-financial information.

7.97 In December 2003, ASIC released the *Section 1013DA disclosure guidelines*, which are designed to help product issuers meet their obligations under paragraph 1013D(1)(l). According to the ASIC guidelines they:

> ...do not set out what constitutes a labour standard or an environmental, social or ethical consideration, or what methodology product issuers should use for taking these issues into account. The guidelines do, however, make it clear that you must disclose *which* of these standards and considerations you take into account and *how*. If you have no predetermined approach, then this too must be clear. The more a product is marketed on the basis that such standards and considerations are taken into account, the more detail is required.[69]

7.98 Ms McCluskey of Portfolio Partners suggested that ASIC should revise its guidance on section 1013D to make it relevant to mainstream fund managers rather than for the more limited pool of ethical funds:

> ...the [ASIC] guidance note that is associated with [the section 1013D] disclosure requirement is a guidance note for socially responsible and ethical funds reporting; it is not a guidance note for mainstream funds. From first-hand experience, it is very difficult for a mainstream manager to report to that guidance note. If that could be reviewed to be applicable not just to socially responsible and ethical funds but to all managers, I think you would have better reporting by fund managers on what they are doing to incorporate whatever you want to call it—sustainability issues. The super funds can then compare what the different fund managers are doing. I think that would better allow the super funds to get a window into how the fund managers are doing this, because there is a varying level of consideration. That is one thing that I think could give the super funds something better to work with, because those disclosures are really quite basic.[70]

7.99 The Financial Services Institute of Australasia (Finsia) submitted that under ASIC Policy Statement 175.110, licensees are advised to form their own view about how far section 945A (the 'know your client' rule) requires that inquiries be made into a client's attitude to environmental, social or ethical considerations. This was said to be at best 'a 'matter of good practice', but there are no requirements for advisers to broach these issues, and therefore SRI-style options with their clients.'[71]

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69 Australian Securities and Investment Commission, *Section 1013DA disclosure guidelines*, December 2003, p. 3.

70 Ms Amanda McCluskey, Sustainability Manager, Portfolio Partners, *Committee Hansard*, 5 April 2006, p. 71.

71 Financial Services Institute of Australasia, *Submission 146*, p. 10.

7.100 Finsia went on to suggest further research and engagement with the financial planning industry and consumer groups on the possibility of including environmental, social and governance considerations explicitly under section 945A.

Committee view

7.101 The committee supports the need to revise the ASIC guidelines to make them relevant to mainstream fund managers. Such a revision would allow super funds to compare the approaches that different fund managers are taking to the consideration of non-financial information. The committee notes that the ASIC guidelines state: 'we intend to review these guidelines, in light of market conduct, in the first half of 2006.'[72]

Recommendation 12

7.102 The committee recommends that the Australian Securities and Investments Commission revise the *Section 1013DA disclosure guidelines* to be relevant to mainstream fund managers rather than simply to the more limited pool of ethical investment funds.

72 Australian Securities and Investment Commission, *Section 1013DA disclosure guidelines*, December 2003, p. 3.

CHAPTER 8

ENCOURAGING CORPORATE RESPONSIBILITY

8.1 Term of reference (e) of this inquiry requires the committee to consider 'any alternative mechanisms, including voluntary measures that may enhance consideration of stakeholder interests by incorporated entities and/or their directors.'

8.2 With growing international recognition of the importance of non-financial factors to overall company performance, there is a risk that if Australian companies do not keep pace with their overseas counterparts, potential business and investment opportunities may be lost abroad. Therefore, although in the committee's view it is not appropriate to mandate the consideration of stakeholder interests into directors' duties, there is a need to consider seriously options to encourage greater uptake and disclosure of corporate responsibility activities.

8.3 In earlier chapters the committee concluded that amendment to directors' duties is not required and that there should be a continuation of the voluntary approach to sustainability reporting. The committee now turns its attention to the various ways in which corporate responsibility should be encouraged in Australia. This chapter considers in turn the role of investors, business and industry, community groups and government.

Institutional investors

8.4 Chapter 5 outlined a relatively low level of interest by Australian institutional investors in the social and environmental performance of the companies in which they invest. There is however a growing realisation amongst institutional investors of the potential financial impact posed by non-financial risks. As a result institutional investors are beginning to take the issue of corporate responsibility more seriously.

8.5 The main reason that institutional investors have not had a stronger interest in non-financial risk management to date is due to a lack of comparable and robust information on these issues. As the Financial Services Institute of Australasia recognised:

> The responsibility for identifying and managing these risks does not, however, rest with corporations alone. The financial services industry – from fund managers and their buy-side analysts, investment banks and client advisory divisions – all have a responsibility to source, analyse and report to investors on all matters of risk that impact on company operations, both in the current reporting season and over a long-term horizon.[1]

8.6 To seek to improve this situation the committee has made two recommendations in earlier chapters of this report: that Australian institutional

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1 Financial Services Institute of Australasia, *Submission 146*, p. 3.

investors become signatories to the *UN Principles for Responsible Investment* (chapter 5); and for the inclusion of further guidance on the disclosure of a company's top five sustainability risks and associated management strategies (chapter 7). If adopted, these two recommendations will give the investment sector greater access to, and increase the interest in, the non-financial affairs of companies.

8.7 In addition to these two recommendations the committee believes there is scope to educate institutional investors better in relation to the potential financial impacts of non-financial risks. There is scope for both companies and investors, as well as other stakeholders, to understand better the often intangible benefits of 'corporate responsibility activities'. Recommendations regarding these two areas are discussed below in a section on education. If adopted, institutional investors and relevant industry associations are encouraged to support and engage in these initiatives.

Business and industry initiatives

8.8 During the course of this inquiry the committee heard many encouraging and inspirational examples of the activities that corporations are undertaking under the broad banner of 'corporate responsibility'. These activities are often win-win situations whereby companies benefit from improving relations with key stakeholders, and stakeholders benefit from corporate support and expertise.

8.9 There were also numerous suggestions of ways in which business collaborations could leverage each other's knowledge and experiences of corporate responsibility, thus leading to improved performance.

An industry-led corporate responsibility network

8.10 Prominent amongst these was the suggestion of a focussed industry network to concentrate the efforts of the business community. Mr Mather of BT Governance Advisory Service (BTGAS) described the current problems associated with a lack of a common business voice:

> There is a lot of talk going on at the moment, in relation to industry groups, in regard to corporate responsibility. In fact, from a meal-ticket perspective, there is no better meal ticket than organising conferences in this particular area! That is a problem in itself, because it results in fragmentation and a cottage-industry approach.[2]

8.11 Mr Mather went on to recommend the formation of a market-led taskforce. Ms Bisset of the National Australia Bank also recognised the current fragmented approach and the benefits of a broadly-based business group to encourage corporate responsibility:

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2 Mr Erik Mather, Head, BT Governance Advisory Service, *Committee Hansard*, 10 March 2006, p. 75.

> there is some [corporate responsibility] activity, but it tends to be sector specific. At the moment, nothing has really brought cross-industry activity apart from going to workshops and conferences and sharing in that sort of informal way. So I think there would be benefit in having some sort of formal group that encouraged that sharing. ... I think any knowledge exchange and best practice sharing activity where organisations come together ... is always useful, particularly when organisations are first starting on that journey. And then you can raise the bar through the sharing of best practice.[3]

8.12 The committee heard of overseas examples of industry networks. Several submissions referred to the Business in the Community (BITC) initiative in the United Kingdom. BITC describes itself as 'a unique independent business led charity whose purpose is to inspire, engage, and support and challenge companies, to continually improve the impact they have on society.'[4]

8.13 BITC provides a platform for collaboration between businesses and for sharing best practice. It works with business to develop practical and sustainable solutions to manage and embed responsible business practice.[5]

8.14 According to researchers from Monash University, BITC was established in 1982 'in response to perceived failures of business against a backdrop of rising unemployment and urban rioting and attempts to integrate considerations of societal impacts into business strategy'.[6]

8.15 The Australian Business and Community Network (ABCN) advised the committee that 'Companies join BITC because they recognise the value of integrating policy and practice and the internal dialogue this prompts'.[7] The ABCN provided further description:

> ...membership [of BITC) provides a unique platform for ... dialogue to identify and address key challenges facing business and society, as well as an opportunity to connect with a network of international partners. BITC member companies employ over 15.7 million people across 200 countries. In the UK, their members employ over 1 in 5 of the private sector workforce.[8]

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3 Ms Rosemary Bissett, Group Manager, Corporate Social Responsibility, National Australia Bank, *Committee Hansard*, pp 13–14. The two halves of this quote appear in reverse order in the Hansard transcript.

4 http://www.bitc.org.uk/about_bitc/index.html (accessed 1 June 2006).

5 http://www.bitc.org.uk/about_bitc/index.html (accessed 1 June 2006).

6 Hon Dr Ken Coghill, Dr Leora Black, Mr Dough Holmes, Monash University, *Submission 71*, p. 13.

7 Australian Business and Community Network, *Submission 109*, p. 18.

8 Australian Business and Community Network, *Submission 109*, p. 18.

8.16 In addition to BITC, the committee also heard of the European business network CSR Europe. During the inquiry the committee met with a representative of CSR Europe, who provided the following information:

> CSR Europe is the leading European business network for corporate social responsibility with over 60 leading multinational corporations as members. Since its inception in 1995 by the then European Commission President Jacques Delors and leading European companies, the mission of CSR Europe has been to help companies integrate corporate social responsibility (CSR) into the way they do business, every day.
>
> Our practices are not only based upon the sharing of CSR solutions and shaping the modern day business and political agenda on sustainability and competitiveness, but we also offer practical approaches such as stake-holder engagement, helpdesk services, and business exchanges and seminars.[9]

8.17 CSR Europe was originally established as a voluntary European-wide business network with the backing of, and seed funding from, the European Commission. In the past decade its membership has grown from seven founding members to over 60 multinational organisations. CSR Europe is affiliated with 22 national partner organisations including the UK's BITC. Through this extended network CSR Europe acts as an umbrella organisation, representing and assisting around 1800 enterprises across Europe.

Committee view

8.18 The committee notes these models of industry networks, and considers that such a network in Australia would provide a valuable service to both those organisations already actively engaged in corporate responsibility and those that may be looking to integrate corporate responsibility into their business operations and strategies. The committee notes in particular the BITC model, which provides a model of a business led network which has grown from industry itself.

Recommendation 13

8.19 The committee recommends that the Australian Government provide seed funding to establish an organisation, the Australian Corporate Responsibility Network, to be modelled on the United Kingdom initiative Business in the Community.

8.20 The proposed Australian Corporate Responsibility Network should equip its member companies with the expertise to design and implement successful, corporate responsibility business policies, practices and processes that are an integral part of business operations and strategies. It should provide practical resources and services, including expertise, advisory services, and training.

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9 Ms Catelijne Wessels, Senior Director, Membership Services, CSR Europe, private communication, May 2006.

8.21 The proposed Network should be structured so that it has the ability to manage specific sector based (such as an investors' network or an SME network) or issue based (such as workplace safety or energy efficiency) subgroups.

8.22 The proposed Network would be an industry vehicle to raise the level of collective corporate responsibility performance in Australia. As such there should be a clear expectation that after an initial period of funding from public sources, the initiative will be self-funded through membership contributions. There should also be a clear expectation that founding members should make a meaningful contribution to demonstrate their genuine commitment.

8.23 The committee expects that to be successful the proposed Network will need the support of relevant industry associations. The Network should seek to establish linkages with similar business networks elsewhere in the world, including BITC in the UK, CSR Europe, Business for Social Responsibility in the US, and comparable organisations in Asia.

Remuneration

8.24 Chapter 3 points out that there are strong market drivers that influence companies to take a short term view. One element of this market dynamic is short term remuneration packages. The committee heard evidence of the strong short term incentives included in many company directors' and executives' remuneration packages. According to Mr Mather of BTGAS the typical incentive package is based on the company's 12–36 month return to shareholders.[10] The committee was also told of how these short term incentives work against corporate responsibility initiatives and to the detriment of long term shareholder value and company profitability.[11]

8.25 Evidence of some emerging and innovative remuneration components that are linked to specific community, market, environmental, health and safety targets was also presented to the committee. Mr Horne of Alcoa for instance outlined the significant proportion of an employee's performance incentive that can be directly linked to corporate responsibility targets:

> The incentive compensation portion is between two and five per cent at [the supervisor or superintendent] level, ranging to above 30 per cent the higher the individual works in the organisation.[12]

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10 Mr Erik Mather, BT Governance Advisory Service, *Committee Hansard*, 10 March 2006, p. 72.

11 For example, Professor Margaret Nowak, Research Director, Governance and Corporate Social Responsibility Research Unit, Curtin Business School, *Committee Hansard*, 20 February 2006, p. 28.

12 Mr Kim Horne, Refinery Manager, Pinjarra, Alcoa World Alumina Australia, *Committee Hansard*, 20 February 2006, p. 15.

8.26 Mr Horne's evidence is consistent with that of other witnesses which suggests that employees that are higher in an organisation are more likely to have a component of their remuneration linked to long-term and corporate responsibility performance.

8.27 Mr Mather also provided an example:

> where the chief executive's performance bonus is measured against, in part, international ratings in relation to global responsibility; I think in that case it is the Dow Jones sustainability index.[13]

8.28 Such incentives appear to be effective in refocusing management decisions. When asked by the committee Chair 'has this actually changed managers' approach in practice?' Mr Horne of Alcoa responded 'absolutely'.[14]

Committee view

8.29 The committee notes that providing financial incentives to company directors, executives and managers is an effective way to encourage companies to take a longer term view, which will ultimately be in the better interests of the company, its shareholders and company stakeholders.

Recommendation 14

8.30 The committee recommends that investors, stakeholders and relevant business associations should encourage companies to include long term (beyond a three to five year timeframe) and corporate responsibility performance measures as part of the remuneration packages of company directors, executive officers and managers.

Sectoral initiatives

8.31 During the course of the inquiry the committee heard evidence of a range of sectoral initiatives to encourage greater participation in corporate responsibility activities. These included initiatives in the mining and finance industries.

Mining sector

8.32 The committee was referred to *Enduring value: the Australian minerals industry framework for sustainable development,* an initiative of the Minerals Council of Australia (MCA) in 2004. This initiative requires signatories (a condition of MCA membership) to assess the systems used to manage key operational risks and publicly report sustainability information based on the GRI indicators. According to Ms Cohen of the WA Chamber of Minerals and Energy, *Enduring Value*:

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13 Mr Erik Mather, BT Governance Advisory Service, *Committee Hansard*, 10 March 2006, p. 72.

14 Mr Kim Horne, Refinery Manager, Pinjarra, Alcoa World Alumina Australia, *Committee Hansard*, 20 February 2006, p. 15.

> provides a framework for incorporating sustainable development in business operations, and many companies are framing their activities around that initiative and the principles within that document and also reporting along those lines.[15]

Finance sector

8.33 Various members of Australia's finance sector (including banks, credit unions, super funds and insurers) are also involved in the United Nations Environment Programme Finance Initiative (UNEP FI). This initiative is designed to 'identify, promote and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.'[16] Nine Australian financial institutions are signatories to the UNEP FI, which commits them to the integration of environmental considerations into all aspects of their operations and services.

8.34 Several large Australian finance sector organisations have also made significant contributions to the development and testing of the GRI's *Financial Services Sector Supplement*.

8.35 Another important finance sector initiative that was brought to the committee's attention is the recent launch of a Credit Union CSR Toolkit developed by the Credit Union Foundation Australia.[17] The Toolkit is designed to allow the 151 credit unions across Australia to plan and report more effectively on their corporate responsibility activities. This initiative is particularly important as it enables credit unions and other small to medium enterprises an accessible and cost-effective way to engage in sustainability activities and reporting.

Committee view

8.36 The committee is strongly supportive of such sector specific initiatives. Because particular industries often face similar stakeholder and sustainability reporting issues, a sectoral approach will often be an effective and efficient way to improve. A sectoral approach allows organisations to benchmark their performance against their peers thus creating competitive tension, leading to best practice. This trend is in evidence in sustainability awards, and also in recognition received by, and sustainability reporting rate of, actively engaged sectors such mining and finance.

8.37 The committee also notes comments from prominent associations such as the BCA that 'given the importance of improving understanding of the benefits of CSR,

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15 Ms Allison Cohen, Executive Officer, Indigenous Affairs and Land Access, Chamber of Minerals and Energy, Western Australia, *Committee Hansard*, 20 February 2006, p. 50.

16 Australasian Operational Environmental Management and Reporting Advisory Committee of the United Nations Environment Programme Finance Initiative, *Submission 127*, p. 2.

17 Correspondence from the Credit Union Foundation Australia to the Chair of the Committee, Senator Grant Chapman, 13 April 2006.

the BCA will do what it can to encourage Members to better publicise their CSR activities.'[18]

8.38 The committee believes there is a role for industry associations and peak bodies to promote actively the benefits of corporate responsibility to, and encourage greater engagement by, their members.

Recommendation 15

8.39 The committee recommends that industry associations and peak bodies actively promote corporate responsibility to their members.

Communication of corporate responsibility information

8.40 The current inefficiencies in the communication of corporate responsibility information to financial markets were raised as an issue during the inquiry.

8.41 On the one hand, there is evidence that many companies find onerous the task of providing sustainability information, often in response to surveys. Sustainable Asset Management, which conducts sustainability assessments of Australian companies, has an annual sustainability survey which includes 70-90 questions.[19] On its own this would not be an overly burdensome undertaking. However, companies often receive several if not many similar questionnaires annually from ratings and research agencies, fund managers, and representative bodies. Boral described the problem as 'survey fatigue'.[20]

8.42 Conversely, fund mangers, institutional investors and other stakeholders spend considerable time attempting to source corporate responsibility information, and are often not satisfied with the information they eventually receive.

8.43 To address this issue a market-based, industry initiative was recommended to the committee. The Australian Banker's Association (ABA) recommended an online tool modelled on the London Stock Exchange's Corporate Responsibility Exchange to enhance and streamline the dissemination of policies and practices in the area of corporate responsibility. In making this recommendation the ABA drew upon the experience of its members operating in the UK market. ABA's submission explains:

> This market driven approach may also give greater credibility and rigour to benchmarks of corporate responsibility practices.
>
> The ABA would envisage that this mechanism would complement existing reporting and disclosure practices and would not impose additional

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18 Business Council of Australia, *Submission to the Corporations and Markets Advisor Committee's Corporate Social Responsibility inquiry*, p. 8, www.camac.gov.au/camac/camac.nsf/byHeadline/PDFSubmissions_2/$file/BCA_CSR.pdf (accessed 30 May 2006)

19 Sustainability Asset Management, *Submission 137*, p. 16.

20 Boral Limited, *Submission 85*, p. 4.

> regulatory burdens on listed companies. Experience in the UK suggests that indeed this approach has reduced the burden on companies that receive many requests for information from market analysts, benchmarking researchers, etc.[21]

Committee view

8.44 In the committee's view a central, web-based location for sustainability information would be a cost-effective way for companies to respond to multiple requests for information. It would also allow immediate access to information for interested market participants as well as concerned community stakeholders.

8.45 The committee considers that the Australian Stock Exchange would be the most appropriate body for developing and administering this web-based tool. To ensure that the web-based tool meets the needs of various interest groups, the ASX should consult with companies, institutional investors and rating agencies in its development. In this process the developers should bear in mind the need to provide any quantitative information in a format that is accessible and useful to investors and analysts.

Recommendation 16

8.46 The committee recommends that the Australian Stock Exchange, in consultation with companies, institutional investors and rating agencies, establish and operate a central web-based tool for the dissemination of sustainability information, based on the London Stock Exchange's Corporate Responsibility Exchange. The Australian Government should consider whether both facilitation and seed funding is required to establish such a service.

Dissemination of best practice information to business

8.47 In a later section of this chapter the committee addresses the engagement of not-for-profit organisations, and recommends that best practice examples of corporate responsibility business partnerships between not-for-profits and the private sector be promoted. The committee is also of the view that best practice examples could be promoted across the spectrum of corporate responsibility activities. The promotion and publication of the many innovative initiatives that are being implemented across corporate Australia would encourage all to consider such actions and would ultimately raise the standard of corporate responsibility throughout Australia. Examples of best practice initiatives that were brought to the committee's attention include:

- Commitment by several mining companies to spend not less than one per cent of their annual pre-tax profits on sustainable development;
- Inclusion of longer term, sustainability performance indicators in directors and senior managers' remuneration packages;

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21 Australian Banker's Association, *Submission 106*, p. 18.

- Effective stakeholder engagement strategies; and
- Mutually beneficial community business partnerships such as:
  - The Smith Family's partnership with BHP Billiton in the Learning for Life literacy program
  - Habitat for Humanity's partnership with a wide range of corporate partners and low-income families to build affordable homes
  - The Body Shop's support for The Big Issue magazine which supports hundreds of homeless people in Australia
- Sustainable supply chain management initiatives from organisations such as Westpac.

8.48 The committee is of the view that the business-led Australian Corporate Responsibility Network, proposed earlier in this chapter, would be the appropriate organisation to undertake the role of publicising and promoting examples of best practice across the spectrum of corporate responsibility activities and across industry sectors. Such an approach would complement rather than duplicate the Prime Minister's Community Business Partnership Awards (mentioned previously and detailed later in this chapter), by communicating the profile of successes with greater impact than is presently the case. As Dr Simons of the Smith Family put it in evidence:

> The [Prime Minister's Business Community Partnership Awards] are fine as far as they go but we would like to see some way of communicating in a more consistent and regular fashion the importance of this...[22]

Recommendation 17

8.49 The committee recommends that the proposed Australian Corporate Responsibility Network publicise and promote best practice examples across the spectrum of corporate responsibility activities and across industry sectors.

Initiatives of community and not-for-profit organisations

8.50 The committee also heard evidence regarding the community and not-for-profit sector's own management of non-financial impacts and risks. The question of whether not-for-profit organisations should meet the same standards as profit-driven corporations was discussed, particularly in the context of the not-for-profit sector needing to legitimise their own advocacy of these principles by setting a good example. The committee recognises that corporations may feel unfairly targeted by measures affecting their interests that do not apply equally to not-for-profit incorporated entities of similar size.

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22 Dr Robert Simons, National Manager, Strategic Research and Social Policy, The Smith Family, *Committee Hansard*, 23 November 2005, p. 56.

8.51 In evidence, the Brotherhood of St Laurence suggested that for-profit companies, rather than non governmental organisations (NGOs) or other community organisations such as churches, should be the principal focus of efforts to ensure corporate responsibility:

> I do not think that is highly relevant to this inquiry at this time. We see growing pressure on enterprises to demonstrate that they are good corporate citizens, that they have a considered an active approach to promoting corporate social responsibility and good governance, and that that be monitored independently and reported against. Those very same tools of a CSR framework are increasingly being applied to the NGO sector...from my observations working for the non-government sector, I can assure you that the rigours and demands on us to be more accountable, open and transparent about how we conduct our own affairs and our business are very strong.[23]

8.52 However, other witnesses indicated that the not-for-profit sector had to place greater importance on leading by example. Ms Cox told the committee that:

> I would say that the not-for-profit area should have been offering leadership on what good corporate citizenship was about. Instead of that, they think they are doing good because they are set up to do good, but they do not actually examine what they are doing. I think they could probably add something—this was one of the points I made recently, and not very popularly, at an ACOSS congress. I said that the not-for-profit section should actually be providing some leadership in deciding what good corporate ethics could be. Some of the big not-for-profits...are very lax in terms of what they do in their own internal management. They prate ethics on their websites, and even publicly at conferences, but they run themselves like a corporation, a fairly hard-nosed corporation, and I think that they lose out on the capacity for being other things.[24]

8.53 The Smith Family told the committee that they were leading the not-for-profit sector in corporate governance:

> ...before we undertook the change agenda that has been driving our shift from a traditional welfare organisation to a social enterprise with a preventive early intervention strategy focusing on education and lifelong learning, the very first task was to look at our corporate governance. We developed a model that we believe to this day is cutting edge in the not-for-profit sector. That was a proactive move to make sure that if we were going to talk about corporate responsibility we had all of the previous

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23 Ms Serena Lillywhite, Manager, Ethical Business, Brotherhood of St Laurence, *Committee Hansard*, 24 February 2006, p. 29.

24 Ms Eva Cox, Senior Lecturer and Program Director, Faculty of Humanities and Social Sciences, University of Technology Sydney, *Committee Hansard*, 10 March 2006, pp 47–48.

> or prior work that needed to be in place within the Smith Family situated there.[25]

8.54 The Australian Council of Social Service (ACOSS) suggested that many NGOs are keen to implement corporate responsibility initiatives, but those with limited resources often found this to be a difficult burden:

> There are a few things...that distinguish them from companies operating for profit. One is that directors are almost always unpaid or voluntary, yet they carry the same weight of responsibility, which needs to be taken into account when you are looking at additional responsibilities. Many organisations are small, with extremely limited resources, and are entirely reliant on government funding that often does not keep up with CPI. That means they have very limited control over their purchasing practices and very little market power, which places them in a more difficult position when it comes to issues such as where products come from.
>
> A further issue is that the legislative environment is very complex...That means that the general compliance costs of running an organisation in the not-for-profit sector are often higher and are often borne in some part by volunteers. I think many organisations are willing to engage in corporate social responsibility but they require more information and support than many private sector corporations in order to achieve that shift.[26]

8.55 ACOSS representatives also told the committee that while most not-for-profit organisations implemented good corporate practices internally, this is not universal:

> As within any sector, you would find some variations in practice. I think that, in general, not-for-profit organisations try to do well by their employees. The salary levels are so low and the funding levels are so low that you have really serious labour force issues, so when you find a staff member you want to try and retain them. But it would be unfair to say that there is not a variation in practice across the sector.[27]

Committee view

8.56 The committee notes that in general, corporate responsibility alerts for-profit corporations, which were traditionally focussed on economic considerations, to the social and environmental impact of their operations. In the same vein, not-for-profit corporations which were generally alert to the social or environmental factors (depending on their area of expertise) should use the concept of corporate responsibility to alert them to the economic and social or environmental impacts of

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25 Dr Robert Simons, National Manager, Strategic Research and Social Policy, The Smith Family, *Committee Hansard*, 23 November 2005, p. 58.

26 Mr Alan Kirkland, Treasurer, Australian Council of Social Service, *Committee Hansard*, 23 November 2005, pp 67–68.

27 Mr Alan Kirkland, Treasurer, Australian Council of Social Service, *Committee Hansard*, 23 November 2005, p. 78.

their operations too. The committee is of the view that the not-for-profit sector must endeavour to meet the same standards as those expected of the for-profit sector.

Recommendation 18

8.57 The committee recommends that the corporate not-for-profit sector should endeavour to meet the same standards as the corporate for-profit sector in considering the interests of stakeholders.

8.58 Furthermore the Australian Government should consider options to encourage NGOs to implement corporate responsibility initiatives within their own operations. These should include options to educate NGOs of the benefits of corporate responsibility and to provide best practice examples of corporate responsibility business partnerships between NGOs and the for-profit sector. The committee makes several recommendations along these lines in a later section of this chapter in relation to the role of government in providing education on corporate responsibility.

The role of government

8.59 Above and beyond its legislative and regulatory role, it is clear from the evidence that government has a role in facilitating and promoting corporate responsibility. This expectation is demonstrated in the results from CPA Australia's *Confidence in Corporate Reporting 2005* survey. The report found that government was nominated as the third most responsible entity (slightly behind company boards and CEOs) when respondents were asked 'who could be responsible for a company meeting its environmental and social obligations'.[28]

8.60 The Australian Government is currently undertaking a range of activities designed to promote corporate responsibility, including the Prime Minister's Community Business Partnership and various sustainability initiatives. These activities, which are discussed below, broadly fall into three categories: leadership, education and recognition. A fourth category – incentives – is subsequently discussed.

8.61 Other sustainability initiatives which were discussed in earlier chapters include: Senator Campbell's reference to the ASX Corporation Governance Council; publishing sustainability reporting surveys and guidelines; engaging the finance sector; and promoting the OECD Guidelines for Multinational Enterprises.

Prime Minister's Community Business Partnership[29]

8.62 Established by the Prime Minister in 1999, the Prime Minister's Community Business Partnership (the Partnership) is a group of prominent Australians from the community and business sectors who work to:

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28 CPA Australia, *Confidence in Corporate Reporting 2005*, November 2005, pp 2–3.

29 This section is based on *Submission 133* by the Department of Families, Community Services and Indigenous Affairs.

- foster community business partnerships;
- act as a 'thinktank' on philanthropic matters; and
- promote corporate giving and corporate social responsibility.

8.63 Both the Prime Minister and the Minister for Families, Community Services and Indigenous Affairs are actively involved in the Partnership as Chair and Deputy Chair, respectively. The Partnership is supported by a secretariat based in the Department of Families, Community Services and Indigenous Affairs (FaCSIA).

8.64 The work of the Partnership is underpinned by the concept of the 'social coalition' – the idea that government, community and business have a responsibility to the wider community, and that through working together to address societal challenges, better outcomes will be achieved. Dr Simons of the Smith Family commented on the benefits of this approach:

> The social coalition prompted by the Prime Minister's community business partnerships scheme is a form of CSR that moves beyond isolated instances of corporate philanthropy to strategic, longer term and active partnerships.[30]

8.65 The Partnership's work program focuses on the strategies of recognition and awareness raising, facilitation and advocacy.

Prime Minister's Awards for Excellence in Community Business Partnerships

8.66 Since the Awards were established in 1999, over 1500 outstanding community business partnerships have been recognised for their contribution to addressing community concerns. Several submitters to this inquiry have been recognised in past years.

8.67 The Awards are divided into *Small, Medium* and *Large* business categories, and are presented at the state and territory level and at a national level. According to FaCSIA 'the Awards have succeeded in generating a greater understanding of the relationships and interdependencies between communities, business and governments.'[31]

Facilitation

8.68 The *Workplace Giving Australia* initiative encourages medium and large businesses to establish a workplace giving program to enable employees to make regular pre-tax donations to charitable organisations.

8.69 A *National Community Business Partnerships Brokerage Service* was seed-funded through the Partnership in 2003. Since its establishment, this Brokerage

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30 Dr Robert Simons, National Manager, Strategic Research and Social Policy, The Smith Family, *Committee Hansard*, 23 November 2005, p. 55.

31 Department of Families, Community Services and Indigenous Affairs, *Submission 133*, p. 3.

Service has facilitated the development or expansion of around 200 community business partnerships across Australia. The service provides advice and information about establishing and maintaining community business partnerships to small and medium sized businesses and community groups and assists them to identify partners.

Education

8.70 In 2005 the Partnership funded a comprehensive study, the *Giving Australia: Research on Philanthropy in Australia* project, which surveyed the contributions of money and time by Australian individuals and businesses. Other major awareness activities undertaken by the Partnership include: *National Community Business Partnerships Week*; the *Corporate Social Responsibility Essay Competition*; and the sponsorships of various conferences and seminars. The essay competition provides an opportunity for both high school and university students to express their opinions about the role of business in society. To date over 800 students have entered the competition, writing essays on a range of issues relating to corporate social responsibility.[32]

8.71 In general, evidence to the committee suggested that the work of the Partnership was seen as a positive step by the Australian Government to promote corporate responsibility. However, there were some suggestions to broaden the scope of the Partnership beyond what some submitters saw as a narrow focus on philanthropic matters. For example Amnesty International submitted:

> Since 1999 the Australian Government has taken a strong stand to support initiatives like corporate philanthropy and workplace giving, through the Prime Minister's Community Business Partnership. We believe the opportunity is for the Australian Government to extend the Community Business Partnership into a wider campaign aiming to improve standards of corporate behaviour.[33]

8.72 However other submitters, such as Ms Mostyn of Insurance Australia Group (IAG) pointed out that the Partnership had already begun to broaden. Ms Mostyn said 'I think there has been a shift [in the Partnership] over time that makes it a much more interesting model of sustainable business than philanthropy.'[34]

Committee view

8.73 The committee is strongly supportive of the various activities of the Partnership, and believes that it is a most effective vehicle to recognise and promote innovative collaborations between corporate Australia and the community sector. The committee notes evidence that the Partnership appears to be changing its focus over

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32 Department of Family and Community Services, *Submission 133*, p. 3.

33 Amnesty International, *Submission 90*, p. 13.

34 Ms Sam Mostyn, Group Executive, Culture and Reputation, Insurance Australia Group, *Committee Hansard*, 9 March 2006, p. 17.

time towards the promotion of a more sustainable business model, and the committee strongly supports this trend.

Recommendation 19

8.74 The committee recommends that the Prime Minister's Community Business Partnership continue to move beyond its initial focus on philanthropy, towards a broader sustainability framework.

Leadership – sustainability in government

8.75 Several submissions suggested that government should take a stronger leadership role in corporate responsibility so as to set an example for corporate Australia. The committee received evidence of the various activities that government departments are undertaking in this regard.

Sustainability reporting by government agencies

8.76 FaCSIA and DEH recently commenced sustainability reporting of their activities and operations, in 2003 and 2004 respectively. Both departments submitted that they found their respective sustainability reporting has led to improved business operations, with FaCSIA stating 'the processes to enable reporting have improved key business systems, resulting in improved sustainability outcomes and savings to the department.'[35] Other government agencies including the Department of Defence, CSIRO, and the Australian Nuclear Science and Technology Organisation have prepared reports on various aspects of their non-financial performance.

8.77 The committee notes the findings from the December 2005 Australian National Audit Office report, *Cross Portfolio Audit of Green Office Procurement* (the ANAO report), which shows that the rate of sustainability reporting within government departments is well below that of corporate Australia. By comparison with the top 500 Australian companies reporting rate of 23 per cent, the government agency rate is around 3 per cent.[36] A DEH representative explained that part of the reason for this trend is that:

> Government is not reporting to the investment community in the same way. You do not look at alternative investments in government agencies in the same way as you look at investments in the private sector, so there are different contexts and environments...[37]

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35 Department of Families, Community Services and Indigenous Affairs, *Submission 133*, p. 9.

36 Derived from Australian National Audit Office, *Cross Portfolio Audit of Green Office Procurement*, December 2005, p. 64, which shows that 2 of 71 government agencies audited, are currently preparing sustainability reports.

37 Mr Gene McGlynn, Assistant Secretary, Department of the Environment and Heritage, *Committee Hansard*, 27 March 2006, p. 39.

8.78 DEH went on to explain that there are specific areas of non-financial performance where the public sector disclosure goes beyond the private sector. The example he gave was the very detailed whole-of-government energy report which the Australian Government produces annually and which exceeds what most companies would produce. The ANOA report also indicates that 'Reporting on environmental performance is likely to improve in some Australian Government bodies in the future with 11 respondents indicating that they were planning a triple bottom line report within the next three years.'[38]

Improving sustainability performance of government agencies

8.79 DEH works with agencies across the Australian Government to improve environmental performance. It provides advice on best practice environmental management systems and public sustainability reporting, and encourages consideration of relevant environmental impacts in Australian Government purchasing.

8.80 FaCSIA has a workplace giving program in place where staff can choose to donate funds to a charity of their choice from their pre-tax pay. FaCSIA also supports staff to give to the community in other ways such as allowing staff to take up to three days per year of paid leave to volunteer for charities.

8.81 The Australian Government is a large purchaser of goods and services, from office supplies to building management services. The ANAO report found that in 2003–04 the Australian Government spent $17 billion on procurement.[39] Its purchasing decisions therefore have the ability to influence market direction.

8.82 The Australian Government has a green procurement policy which indicates that it is seeking to be at the forefront in environmental purchasing practice through:

- buying goods and services that seek to minimise possible environmental impact;
- working with industry to encourage continuous reduction in the adverse environmental impact of goods and services; and
- assessing the environmental impact of goods and services against informed and internationally recognised standards and methods.[40]

8.83 The ANAO report concluded that, despite a small number of better practice examples of green office procurement across the Australian Government:

38 Australian National Audit Office, *Cross Portfolio Audit of Green Office Procurement*, December 2005, p. 18.

39 Australian National Audit Office, *Cross Portfolio Audit of Green Office Procurement*, December 2005, p. 15.

40 Policy framework for Greening of Government website, www.deh.gov.au/settlements/government/purchasing/policy.html (accessed 19 May 2006).

> ...overall there were significant shortcomings identified in terms of the application of whole of life cycle costing and in the management of the environmental impacts of procurement decisions. Compliance with Australian Government policy requirements has improved over time in areas such as energy efficiency in buildings with important greenhouse gas emissions and cost savings being achieved.[41]

8.84 In relation to Environmental Management Systems (EMSs) of government agencies the ANAO report found:

> Implementing EMSs (one of the key management controls designed to improve environmental performance) has been slow and few agencies have met the timetable originally envisaged by the Government. In addition, the audit has highlighted the absence of specific requirements in areas such as waste management and water conservation and shortcomings in agencies meeting the Government's stated objective to be at the forefront of environmental purchasing practices. As a consequence, sustainable development has not, as yet, been fully integrated into Australian Government operations.[42]

8.85 Of particular concern is the wasteful use of public funds, with the ANAO finding that 'financial savings of almost $10 million per annum could be achieved if agencies were more proactive in energy and water conservation in particular.'[43]

8.86 In addition to the issue of government agencies and their sustainability and green procurement reporting, the committee notes that there are legislative requirements and government policies in existence that specifically address environmental performance by government agencies. Section 516A of the *Environment Protection and Biodiversity Conservation Act 1999* (EPBC Act) requires Australian Government agencies to report on the effect of their actions on the environment and identify any measures to minimise the impact of these actions on the environment. Less than half of the ANAO survey respondents (41 per cent) indicated that they had reported the effect of their procurement actions on the environment.

8.87 DEH officials presented evidence to the committee that apart from the requirement under section 516A of the EPBC Act there is no reporting requirement regarding government policies on departmental environmental performance in areas such as:

- implementation of Environmental Management Systems;

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41 Australian National Audit Office, *Cross Portfolio Audit of Green Office Procurement*, December 2005, p. 24.

42 Australian National Audit Office, *Cross Portfolio Audit of Green Office Procurement*, December 2005, p. 24.

43 Australian National Audit Office, *Cross Portfolio Audit of Green Office Procurement*, December 2005, p. 24.

- providing instructions or internal policies on whole of life cycle costing; and
- green vehicle purchasing.[44]

8.88 In each of these areas the ANAO report found 'significant shortcomings'[45] in government departments' compliance with these government policies. The committee notes that some government agencies are failing to comply with government policy and that there is no mandatory requirement for disclosure.

Committee view

8.89 The committee would like to see the rate of government agency sustainability reporting to continue to rise into the future. In this regard the committee is encouraged that more government agencies have plans to undertake sustainability reporting in the near future.

8.90 The committee commends those agencies which are reporting in accordance with requirements under section 516A of the EPBC Act, and those that are complying with and reporting on their compliance with government policies on departmental environmental performance. The committee expects those agencies that are not complying to commence doing so.

8.91 The committee believes that government agencies should demonstrate leadership by improving their performance in the area of green procurement and implementation of environmental management systems. The committee acknowledges the efforts of those agencies already taking steps in this regard. The committee also endorses the recommendations of the ANAO report.

44 Dr Paul Starr, Senior Policy Officer, *Committee Hansard*, 27 March 2006, p. 40. The various policies are discussed in Australian National Audit Office, *Cross Portfolio Audit of Green Office Procurement*, December 2005, pp 16–20. Improvements in the energy efficiency performance of government buildings were the significant exception, although the report found that further improvements in this area were possible. In this area DEH prepares an annual report.

45 Australian National Audit Office, Cross Portfolio Audit of Green Office Procurement, December 2005, p. 24

Recommendation 20

8.92 The committee recommends that, in order to show greater leadership and to encourage more agencies to disclose their sustainability performance, the Australian Government establish:

- **voluntary sustainability reporting targets for government agencies;**
- **voluntary targets for government agency procurement in areas such as water, waste, energy, vehicles, equipment and consumables; and**
- **a requirement for each government agency to disclose such targets and to detail progress towards achieving these in its annual report.**

Investment – Future fund

8.93 As discussed in chapter 5, in order for the Government to show significant leadership in the responsible investment of public funds, the committee has recommended that the Future Fund adopt the UN's voluntary *Principles of Responsible Investment* to guide its investment practices.

A coordinating government department?

8.94 Many submitters recognised that the current delivery of government corporate responsibility programs occurs in a seemingly uncoordinated fashion amongst a number of government departments. For example, the Insurance Australia Group submitted:

> Currently, a limited number of government agencies have specific agendas to drive some CR and related activities. In the Commonwealth, examples include the Department of Environment and Heritage, the Department of Family and Community Services and the Australian Greenhouse Office, which all deliver a variety of programs aimed at providing incentives for corporate responsibility activity.[46]

8.95 A similar comment was made by the Australian Centre for Corporate Social Responsibility:

> The Australian Government may have numerous ways in which it encourages corporate social responsibility, but a lack of coherence and focus of initiatives and policies makes this difficult to ascertain.[47]

8.96 The committee considers that this sporadic approach detracts from the leadership role that government should play in the field of corporate responsibility. The committee believes that the approach taken by the UK government, which has consolidated the government's sustainability initiatives within the Department of

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46 Insurance Australia Group, *Submission 29*, p. 24.

47 Australian Centre for Corporate Social Responsibility, *Submission 63*, p. 6.

Trade and Industry, is one approach to consider. The alternative is to use a whole-of-government approach.

Recommendation 21

8.97 The committee recommends that the Australian Government's various corporate responsibility programs be co-ordinated through a whole-of-government approach.

A minister for corporate responsibility?

8.98 Several submissions suggested that the Australian Government should raise the profile of corporate responsibility by appointing a minister for corporate responsibility, as the UK and France have done.[48]

8.99 In this regard the committee notes that various government ministers already play a significant role in promoting corporate responsibility. For example ANZ Bank representative Mr Brown noted the role being played by the Parliamentary Secretary to the Treasurer:

> Chris Pearce, the Parliamentary Secretary to the Treasurer, has been playing a very active role in relation to encouragement and recognition already and has made a range of speeches which are directly relevant to the financial services sector, which we very much welcome. He has already been very active, and if one was looking for an immediate model here, that is certainly one that we would identify.[49]

8.100 Earlier in this report the committee has noted the initiative of the Minister for the Environment and Heritage, Senator Campbell of referring matters concerning sustainability reporting to the ASX Corporate Governance Council.

Committee view

8.101 The committee is of the view that given the broad nature of corporate responsibility it is more appropriate to allow existing government ministers to deal with the particular aspects of corporate responsibility which lie within their area of expertise.

Education

8.102 The committee regularly heard that encouraging corporate responsibility through the education of directors, investors and other stakeholders was a key role for government. For example Mr Sheehy of Chartered Secretaries Australia stated

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48 For example, the Australian Centre for Corporate Social Responsibility, *Submission 63*, p. 6.

49 Mr Gerard Brown, General Manager, Corporate Affairs, Australia and New Zealand Banking Group Ltd, *Committee Hansard*, 5 April 2006, p. 37.

'we most definitely think that there would be a role for government in the education and encouragement process.'[50]

8.103 The Australian Government is already taking a lead role in education on corporate responsibility, as outlined above in the section on the Prime Minister's Community Business Partnership. Another important example is DEH's support for the Australian Research Institute in Education for Sustainability (ARIES) at Macquarie University, which is working with Australian business schools on how to teach sustainability in business education. Following a review of the current level of sustainability education in Australian MBA courses, the department is working closely with ARIES and five of Australia's leading business schools[51] to effect change in the syllabus within a two year period. Pending progress of the study, additional business schools may be invited to participate in the project in 2006.[52]

8.104 Several submitters also suggested that there is a role for business associations such as the Australian Institute of Company Directors, the Business Council of Australia and the Chartered Secretaries of Australia in educating their members on corporate responsibility and disclosing non-financial information.[53]

Committee view

8.105 The committee agrees that government has a strong role to play in educating both directors and company stakeholders to raise their awareness of corporate responsibility. Clearly it is already doing so in a number of areas (outlined above). Based on the evidence received, the committee is recommending further educational initiatives relating to four specific areas of corporate responsibility:

- educate mainstream investors;
- conduct research into the benefits of corporate responsibility;
- promote the Global Reporting Initiative; and
- educate not-for-profit organisations.

8.106 In each of these areas, the development of educational programs and material should occur in consultation and collaboration with relevant business groups.

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50 Mr Tim Sheehy, Chief Executive, Chartered Secretaries Australia, *Committee Hansard*, 23 November 2005, p. 50.

51 Macquarie Graduate School of Management, the Australian Graduate School of Management, Melbourne Business School, the University of Technology Sydney Graduate School of Business and the University of Queensland Business School.

52 Department of the Environment and Heritage, *Submission 116*, p. 4.

53 For example, Mr Eric Mayne, Chair, Australian Stock Exchange Corporate Governance Council, *Committee Hansard*, 10 March 2006, p. 12; and Mr Tim Sheehy, Chief Executive, Chartered Secretaries Australia, *Committee Hansard*, 23 November 2005, p. 43.

Educate mainstream investors

8.107 A recurring theme throughout the inquiry was the need to educate financial market participants in order for them to value non-financial risks better. For example Ms Bisset of the National Australia Bank put the point clearly and succinctly:

> We still have a very important role in educating mainstream analysts about the value of [non-financial] information, so they are able to get a good assessment of our performance as a business now and in the future.[54]

8.108 An official of the Treasury agreed that this is an area where the government can play a leadership role:

> I think there is an issue of education of institutional investors. I mentioned earlier that there is a growing view amongst institutional investors that they need to start thinking about things like the greenhouse impact of the companies they are investing in if they are going to grow value in these companies over a very long time. To the extent that government can take a leadership role in providing information and making that kind of analysis easier, I think that would be a very useful path to go down.[55]

8.109 The committee acknowledges previous work undertaken in this area, funded by government, including the 'Mays Report'. This study examined sustainability issues through the eyes of investors, and aimed to contribute to awareness of sustainability as an investment tool. Despite this and other studies, the committee is of the view that there remains a need for financial market analysts to be educated better in the impact of non-financial risks.

8.110 In chapter 5 of this report the committee recommended that 'institutional investors in Australia seriously consider becoming signatories to the United Nations Principles for Responsible Investment.' The committee believes there would be value in the government promoting these principles to institutional investors in Australia, because it would lead to a greater degree of adoption.

Recommendation 22

8.111 The committee recommends that the Australian Government, in consultation with the investment community, develop educational material:

- **regarding the materiality of non-financial risks, for use by institutional investors and fund managers; and**
- **to promote the United Nations Principles for Responsible Investment to institutional investors and fund managers.**

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54 Ms Rosemary Bissett, Group Manager, Corporate Social Responsibility, National Australia Bank, *Committee Hansard*, 5 April 2006, p. 6.

55 Mr Matthew Brine, Manager, Governance and Insolvency Unit, Department of the Treasury, *Committee Hansard*, 29 March 2006 p. 16.

8.112 Mainstream investors should also be educated in relation to the digital enhancements being incorporated into the GRI Framework through its third revision (G3). The committee also notes the comments of the National Institute of Accountants regarding the role of accountants:

> We believe that it is the role of the accounting profession in particular to seriously consider the way in which stakeholders, shareholders and others should be educated in the community. There is a fundamental rationale for this. When you empower the owners of companies with knowledge, they are then equipped with the capacity to ask better questions of those who are directors of the companies that they own shares in.[56]

Researching the benefits of corporate responsibility

8.113 During its public hearings the committee invited Treasury officials to comment on their submission which suggested that while the costs of sustainability reporting are reasonably quantifiable, it may be more difficult to assess the benefit to the community.[57] In response a Treasury official indicated that quantifying the benefits of sustainability reporting:

> ...is a problem we have throughout the corporate governance area. While we can always estimate the cost to some degree of accuracy, it is very difficult to estimate the benefits of improved governance. You might cite things like increased access to finance, improved longer term performance, increased access to foreign markets and greater access to employees. It is very difficult to put a dollar figure on those to measure up against the dollar figure of perhaps having people there fulfilling these reporting requirements.[58]

8.114 The ASX submission supports this view, stating that the 'ASX believes further work needs to be done on the specific benefits to the markets of additional disclosure when weighed against the compliance costs of introducing more disclosure requirements.'[59]

8.115 Without a reasonably clear picture of what both sides of cost-benefit analysis on sustainability reporting might look like, it is very difficult to assess accurately the economic implications of various sustainability reporting policy scenarios. For this reason, and to provide further empirical analysis into the corporate responsibility debate, the committee makes the following recommendation.

Recommendation 23

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56 Mr Tom Ravlic, Policy Adviser, Financial Reporting and Governance, National Institute of Accountants, *Committee Hansard*, 5 April 2006, p. 84.

57 Department of the Treasury, *Submission 134*, p. 14.

58 Mr Matthew Brine, Manager, Governance and Insolvency Unit, Department of the Treasury, *Committee Hansard*, 29 March 2006, pp 15–16.

59 Australian Stock Exchange, *Submission 126*, p. 1.

8.116 The committee recommends that the Australian Government, in consultation with relevant sections of the business community, undertake research into quantifying the benefits of corporate responsibility and sustainability reporting.

8.117 This analysis should be carried out both in terms of the benefits for individual companies and for the national economy. The benefits to the national economy might include developing Australia's international profile and competitive position in the global marketplace, increasing its attractiveness as an investment market and partner for regional or international initiatives. The analysis should also be made publicly available. The committee notes that this approach has been used successfully in the UK.[60]

Promotion of the Global Reporting Initiative

8.118 The GRI is widely recognised as the international standard for sustainability reporting. However, as discussed in chapter 7 the committee believes that it is too early to recommend it as the voluntary Australian standard.

8.119 Nonetheless, the committee agrees with many submitters who put the view that the government should actively promote the GRI Framework. For example BHP Billiton submitted 'active promotion of the [GRI] is considered particularly appropriate as it has evolved through an extensive multi-stakeholder engagement program.'[61]

8.120 IAG agreed with the proposition, indicating that it would be particularly valuable for SMEs.

> The one problem we have in Australia on which the government could take a leadership role is...[education] of the small business community around how thinking about some of those aspects of the GRI will make them better businesses, and provision of tools and education would lift the behaviour of smaller companies that struggle with these things and see them purely as punitive regulatory or reporting requirements as opposed to an opportunity to grow better businesses. Education and an understanding of why the GRI

60 For example Business Council of Australia, *Submission to the Corporations and Markets Advisor Committee's Corporate Social Responsibility inquiry*, p. 7, states: 'to support the wider adoption of CSR by business, the UK Government has been exploring the benefits of CSR for general business performance. The UK Government has worked with others on projects looking at the links between CSR or sustainability and business performance, both in terms of the impact on the competitiveness of individual companies and national economies.' See www.camac.gov.au/camac/camac.nsf/byHeadline/PDFSubmissions_2/$file/BCA_CSR.pdf (accessed 30 May 2006).

61 BHP Billiton, *Submission 13*, p. 6.

> can transform a business and play a key role in long-term value would be useful.[62]

8.121 Finally, officials from the Treasury also strongly endorsed the government supporting further education in this area:

> One of the key advantages [in adopting the GRI]...is that you want information that can be presented to investors in other countries and is comparable with what they are asking from their own large corporations and the GRI would certainly seem to get you there. I think there is a role for the government to play where there are costs that can be removed by the government, perhaps in providing advice on how to apply GRI. I think it would be very useful if the government could make people who were interested in non-financial reporting aware of GRI and how to use it.[63]

Recommendation 24

8.122 Although recommending that it is premature to adopt the Global Reporting Initiative Framework, the committee recommends that in addition to the continued monitoring of its uptake, the Australian Government provide guidance to the business community, including the small business community, on how to apply the Global Reporting Initiative Framework.

8.123 In this regard the committee notes the development within the most recent revision of the GRI framework, the G3 initiative, to include reporting and awareness programs.[64] The Government should seek to integrate its efforts as far as possible with these activities under the G3.

Promotion of the UN Global Compact

8.124 In chapter 6 the committee referred to the UN Gobal Compact, an initiative of the UN that facilitates a network of UN agencies, governments, business, labour, and non-government organisations to encourage companies to adopt ten principles in the area of human rights, labour, environment, and anti-corruption. As previously noted, a number of Australian companies are signatories to the UN Global Compact including Shell Australia, BHP Billiton, and Westpac.

8.125 The committee supports the UN Global Compact and acknowledges those Australian corporations that have become signatories. The committee also notes the positive linkages between the Global Compact, the GRI and the recently released UN

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62 Ms Sam Mostyn, Group Executive, Culture and Reputation, Insurance Australia Group, *Committee Hansard*, 9 March 2006, p. 21.

63 Mr Matthew Brine, Manager, Governance and Insolvency Unit, Department of the Treasury, *Committee Hansard*, 29 March 2006 p. 26.

64 Dr Judy Henderson, Chairperson, Global Reporting Initiative, *Committee Hansard*, 10 March 2006, p. 33.

Principles for Responsible Investment. The committee believes there would be value in encouraging more Australian companies to participate in the UN Global Compact.

Recommendation 25

8.126 The committee recommends that the Australian Government develop educational material to promote the UN Global Compact and to encourage Australian companies to become signatories where it is appropriate for them.

Facilitate and coordinate participation in international initiatives

8.127 As well as directly promoting various international initiatives, the government should also facilitate the involvement of Australia's private sector in international corporate responsibility processes. International initiatives such as the GRI, the UN Principles of Responsible Investment and the United Nations Environment Program Finance Initiative can be highly influential in setting the policy direction across the globe. Therefore, if Australian interests are to be considered in the development of such international initiatives, Australian companies must be active participants.

8.128 Australian companies have participated in a number of international initiatives such as the preparation of GRI sector supplements, on a voluntarily basis. However, there has not been a coordinated approach to engagement in international corporate responsibility initiatives. The committee is of the view that government should play a role in facilitating and coordinating the participation of Australian corporations, to ensure Australian interests are considered and protected.

Recommendation 26

8.129 To protect Australia's interests, the committee recommends that where appropriate, the Australian Government facilitate and coordinate the participation of Australian corporations in international corporate responsibility initiatives.

Educate not-for-profit organisations

8.130 As discussed above in relation to the not-for-profit sector, the committee is of the view that the Australian Government should consider options to encourage not-for-profit organisations to implement corporate responsibility initiatives within their own operations. These should include options to educate them on the benefits of corporate responsibility and to provide best practice examples of corporate responsibility business partnerships between the for-profit and not-for-profit sector.

Recommendation 27

8.131 The committee recommends that the Australian Government, in collaboration with relevant not-for-profit organisations, develop educational materials for not-for-profit organisations to promote the benefits of corporate responsibility within their own organisations.

Recognition

8.132 Many submitters also saw a role for government in the recognition of best practice initiatives. For example Mr Brown of the ANZ Bank commented that:

> Recognition ... is very important and can play a useful role in the debate by setting out that this is an action or organisation which has been recognised as better, or best practice, or practising new models. That is very useful for encouraging developments in the private sector.[65]

Committee view

8.133 The committee is of the view that Prime Minister's Awards for Excellence in Community Business Partnerships already provide strong recognition for best practice examples of corporate responsibility. This view is supported by evidence from Mr Gosman, a former employee of Cisco:

> Cisco won the Prime Minister's award on a number of occasions for the work that it does with the Smith Family. Anecdotally, that went around the whole telecommunications industry. That had the effect of lifting the bar for all players, because it is a competitive industry. There is a degree of jealousy. They saw the amount of recognition that Cisco received for what I think was a fantastic program, and it actually led to a lot of other companies looking at how they could move into that space and replicate some of what Cisco was achieving.[66]

8.134 For this reason the committee believes that the government is already recognising organisations that have achieved best practice in corporate responsibility.

Incentives

8.135 Various submitters suggested that the government should provide financial incentives to encourage corporate responsibility, or conversely, to remove existing incentives that work against corporate responsibility. An example which was considered during the inquiry was a revision to the capital gains tax arrangements.

Capital Gains Tax

8.136 Currently, investors receive a one-off capital gains tax concession if they hold a company's shares for a period of 12 months. Beyond that period no additional incentive applies. As a result, once investors reach the 12-month qualifying period, the current arrangements encourage investors to trade their shares rather than hold them for a longer term.

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65 Mr Gerard Brown, General Manager, Corporate Affairs, Australia and New Zealand Banking Group Ltd, *Committee Hansard*, 5 April 2006, p. 37.

66 Mr Alex Gosman, Director, Government and Corporate Affairs, GlaxoSmithKline, *Committee Hansard*, 23 February 2006, p. 52.

8.137 The recent Warburton-Hendry review of Australia's tax regime found that Australia's capital gains tax arrangements were comparatively high and did not reduce over time as is the case in countries such as Denmark and the United Kingdom.[67]

8.138 The suggestion to modify the existing capital gains tax arrangements was suggested to the committee by the Australian Conservation Foundation (ACF). Mr Berger, the ACF's Legal Adviser, described the proposal in the following terms:

> I would encourage the committee to examine the possibility of utilising the capital gains tax system to refocus Australian corporate behaviour on the long term. If you can envision a capital gains tax system where the amount of tax payable is calibrated to the holding period of an investment such that the longer you hold an investment the lower your capital gains tax rate is, you would really instil a deep change in the attitude of funds managers, analysts, corporate executives, trustees and the entire investment value chain. In turn, that would drive a longer term time horizon, a better assessment of long-term investment risk and opportunities and a far deeper and more meaningful consideration of environmental and social concerns.[68]

8.139 Mr Mather of BTGAS indicated that modifying existing capital gains tax arrangements would not dramatically change the investment decisions of institutional investors because '[institutions are] already holding stock for a long time anyway, regardless of the capital gains tax implications, because of risk diversification.'[69]

8.140 Mr Agland of the National Institute of Accountants dismissed the proposal, arguing that changing the tax rules is not the best way to encourage investors to look at a company's sustainability performance:

> If you want them to take a broader look at what their company is all about and why they are investing in it, then they need to have an appreciation for things other than their own financial returns. I do not see merely changing the tax rules as being the catalyst for changing that mentality and it is changing that mentality that will have a broader impact than simply scaling back the [capital gains tax] requirement.[70]

8.141 The Treasury was not supportive of a stepped rate for capital gains tax to reflect a longer term holding of shares. In response to a question taken on notice, Treasury advised that the existing capital gains tax discount, which reduced tax payable by half after 12 months ownership, reduces the incidence of investors

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67 R.F.E. Warburton, *Discussion of International Comparison of Australia's taxes*, April 2006, p. 208.

68 Mr Charles Berger, Legal Adviser, Australian Conservation Foundation, *Committee Hansard*, 24 February 2006, p. 78.

69 Mr Erik Mather, Head, BT Governance Advisory Service, *Committee Hansard*, 10 March 2006, p. 71.

70 Mr Reece Agland, Technical Counsel, National Institute of Accountants, *Committee Hansard*, 5 April 2006, p. 88.

becoming 'locked in' to the investment. The Treasury explained the concept of 'lock in':

> A CGT liability generally arises only when the investor sells an asset or realises it in some other way. This can cause some investors to retain ownership of assets for as long as possible so as not to trigger a CGT liability where they might obtain better returns before tax elsewhere. In other words, they can become 'locked in' to the investment.[71]

8.142 The Treasury went on to indicate that 'lock in' was not desirable, because it 'can distort investment decisions to the detriment of both the investor and the Australian economy by limiting economic growth'. The Treasury pointed out that:

> The CGT discount reduces lock-in. This is because the taxpayer pays tax on only half the capital gain after 12 months. On the other hand, having a stepped-rate system would significantly increase the incentive to lock in. This is because some taxpayers would be motivated not to sell their investments until they were CGT-exempt.
>
> Investors would tend to reject opportunities that might arise within the higher-taxable period for fear of incurring a CGT liability. This would be despite the fact that there might be sound commercial reasons for selling.[72]

Committee view

8.143 In considering the proposal to change existing capital gains tax arrangements, the committee notes the concerns raised by Treasury, and the views expressed by some submitters that such changes would not dramatically change the decisions of institutional investors. The committee also notes that changing tax arrangements always has the potential for unintended consequences. On balance, the committee is not convinced that changing existing capital gains tax arrangements would achieve the suggested benefits in relation to the particular matter relevant to this inquiry. The committee makes no comment on the broader issues relating to capital gains tax reform.

8.144 The introduction or removal of other incentives such as a concession on research and development into innovative partnerships,[73] or revisions to the fringe benefits tax on fleet vehicles[74] were not attractive options in the committee's view.

8.145 In chapter 6, the committee recognised the high initial barrier facing new entrants that may be considering sustainability reporting. In the committee's view there would be merit in investigating whether a write-off incentive to overcome this

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71 Department of the Treasury, *Submission 134A*, pp 1–2.

72 Department of the Treasury, *Submission 134A*, pp 1–2.

73 Mr Alex McDonald, the Body Shop, *Committee Hansard*, 23 February 2006, pp 12–13.

74 Ms Sam Mostyn, Group Executive, Culture and Reputation, Insurance Australia Group, *Committee Hansard*, 9 March 2006, p. 22.

initial hurdle would be an effective mechanism to accelerate corporate responsibility and sustainability reporting in Australia.

Recommendation 28

8.146 The committee recommends that as a way of facilitating greater uptake of sustainability reporting, 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 that commence sustainability reporting for the first time.

Regulatory relief

8.147 The committee also heard a suggestion to encourage greater uptake of corporate responsibility activities and sustainability reporting through regulatory relief. Dr Longstaff of the St James Ethics Centre suggested that 'businesses undertaking these commitments should be eligible for "regulatory relief" – moving from highly prescriptive regimes to a 'principles based' system of co-regulation.'[75]

8.148 In evidence Dr Longstaff gave the example of the Victorian Environment Protection Authority providing regulatory relief for a five-year record of achieving a very high standard in environmental audits. He added that:

> Governments and particularly their regulatory agencies do not have unlimited budgets, and they have to make prudent decisions about where they focus their attention. We are saying that one of the things they might take account of is that, if they have a very high level of performance in an instrument like the Corporate Responsibility Index, it is indicative of there being a safer climate in which they operate.[76]

8.149 Dr Henderson of the Global Reporting Initiative also supported regulatory relief as a mechanism to encourage greater sustainability reporting. She used the example of the NSW Environment Protection Agency, which offers incentives such as lower fees to companies which reduce their pollution.[77]

Committee view

8.150 The committee supports the concept of regulatory relief. It would provide the dual benefits of generating greater uptake of corporate responsibility and also reducing the regulatory burden on business. Essentially this suggestion can be seen as a cost-effective option for encouraging corporate responsibility.

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75 St James Ethics Centre, *Submission 50*, p. 5.

76 Dr Simon Longstaff, Executive Director, St James Ethics Centre, *Committee Hansard*, 23 November 2005, p. 22.

77 Dr Judy Henderson, Chairperson, Global Reporting Initiative, *Committee Hansard*, 10 March 2006, p. 35.

Recommendation 29

8.151 The committee recommends that the Australian Government consider options for providing regulatory relief to corporations which voluntarily undertake specified corporate responsibility activities.

8.152 The regulatory relief should be linked to the types of activities that companies are undertaking, that is in the non-financial sphere. The sort of activities that may be eligible for regulatory relief could include:

- Voluntarily participating in the Corporate Responsibility Index for a specified period;
- Voluntarily undertaking sustainability reporting for a specified period;
- Becoming a signatory to, and implementing the UN Compact or Principles for Responsible Investment; and
- Adopting a particular sustainability reporting framework that encompasses the information already required under specific mandatory disclosure requirements (such as OH&S).

8.153 The committee is of the view that applications for regulatory relief should be subject to verification by ASIC.

8.154 It would be possible to broaden the scope of regulatory relief as a company's commitment, both in terms of duration and level of participation, increased.

SENATOR GRANT CHAPMAN

CHAIRMAN

SUPPLEMENTARY REPORT BY LABOR MEMBERS

Introduction

1.1 The role of the corporation in modern society is changing. Today's corporations are larger, own more assets and are more influential than at any time since the corporate form was founded. The influence of corporations now extends well beyond economics and wealth creation and includes significant social, cultural, environmental and political impacts. The pervasive growth of business and international trade make the external impacts of corporations greater than ever, and with this has come costs as well as benefits to society.

1.2 It is also significant then that at a time when corporate influence is so great, that a number of critical environmental and social conditions are emerging as significant threats. Climate change, reduction of biodiversity, intensifying resource constraints, changing population demographics, international population growth, intergenerational poverty and social exclusion are but some of the more pressing issues. Each one of these issues either directly or indirectly affects Australian business.

1.3 Corporations are not to blame for these growing environmental and social challenges, but as significant and critical contributors to our prosperity and development, they must be part of any effective response. Knowing what we now know about these impacts, corporations and those working within them are uniquely placed to have a direct influence on how these issues are now managed.

1.4 The Labor members consider that corporate responsibility is fundamentally an issue of sustainability. Corporate responsibility is not primarily about charity or company philanthropy. The World Business Council on Sustainable Development provides a useful definition:

> "Corporate [social] responsibility is the commitment of business to contribute to sustainable development, working with employees, their families, the local community and society at large to improve their quality of life."[1]

1.5 In this vein, Labor firmly believes that business must be part of the solution in dealing with emerging sustainability challenges. Positive social and environmental outcomes are no longer the sole domain of government or community groups, and business along with the various stakeholders in business activities are becoming aware

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1 World Business Council of Sustainable Development, www.wbcsd.org

of this fact. As recently stated by Lord Browne, BP Group Chief Executive, in a speech at the Massachusetts Institute of Technology:

> Good, successful business is part of society, and exists to meet society's needs. That is the purpose of business at the highest level.[2]

1.6 It is from this perspective that understanding and taking ownership of the environmental and social impacts of business is becoming a critical aspect of responsible corporate activity.

1.7 Furthermore, in business and government today there is an awareness of the need not to stifle economic growth with regulation that can overly constrain entrepreneurial, innovative and growth oriented forces of business. Put simply, it is not considered good economic policy to overly constrain business. This has led to a lessening of government constraints on business activities in a number of areas.

1.8 At the same time that markets and business activities are further de-regulated, there is a growing gap and urgency in ensuring social and environmental outcomes are achieved. This is a gap in which business and finance sector leaders must assume greater responsibilities. This is no easy task and the pressures of achieving profitability and growth in the short term cannot be underestimated for businesses. None-the-less, business leaders must introduce a systematic approach to managing and improving the consequential social and environmental outcomes of their business operations. If we are to continue achieving economic growth and want to ensure that this growth is sustainable, business will be called on to better integrate sustainable behaviours into its operations.

1.9 The question as to how this balancing act of maintaining growth in the short to medium term and adequately investing in long term growth can be managed is one that requires a more active and engaged response from the business and government sectors. Labor initiated the current parliamentary inquiry into corporate responsibility to develop responses to this question.

Background to the Inquiry

1.10 Labor initiated the Inquiry into Corporate Responsibility for three reasons:

- Parts of the business community in Australia were actively engaged in the re-emerging debate about the role and responsibilities of the corporation in society but government was not.
- Progress by Australian business on the whole regarding integration of corporate responsibility approaches appeared fragmented and lagged behind that of comparable international economies and trading partners.

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2 Speech by Lord Browne, BP Group Chief Executive, at the Massachusetts Institute of Technology (MIT), Boston (2 May 2006)

- Widespread progress by Australian businesses in the integration of sustainable business practices is expected to lead to greater social and environmental benefits, equip those businesses to better manage impending non-financial business threats, and prepare them to seize emerging market opportunities.

1.11 The evidence from many distinguished members of the Australian business, legal and non-government sectors is that they consider their duties to a company's best interests should encompass consideration of stakeholder needs. To give effect to this view and to catch up to the practices of many of our trading partners, more directors should be taking an engaged, long term perspective on their business operations and impacts.

1.12 While recognising that a number of Australian companies have renewed their approach to sustainable, responsible business, evidence to the committee indicates that these companies number in the minority. This leads Labor members to the view that more needs to be done to encourage, support and set direction for companies on sustainability and corporate responsibility issues.

1.13 It is the view of the Labor members that in order to increase the number of corporate, non-government and government organisations that deeply integrate sustainable and responsible activities over the medium term (five to ten years), government must play a more engaged and strategic role now.

1.14 The Labor members believe the main committee recommendations do not promote an adequately coherent and coordinated direction from government to accelerate the take- up of sustainable and responsible approaches in Australia. Accordingly the Labor members have prepared a supplementary report on the Inquiry.

Strategic direction and engagement from government

1.15 In contributing to the future of corporate responsibility, the Labor members recognise the importance of not mandating particular responses by companies and not developing 'one size fits all' regulation. Rather, the objective of government should be to resource companies and provide useful support for business change. It should also help to prepare Australian business for developments that are likely to form de facto mandatory standards in the area of corporate responsibility performance and reporting.

1.16 As indicated by the recent emergence of the Business Roundtable on Climate Change in Australia, non-financial threats, such as climate change, are already altering our business environment and our way of life. As sought by the Roundtable members, clear direction and policy responses from government on sustainability threats such as that posed by climate change, are exactly the kinds of response that responsible business wants from government.

1.17 Labor therefore suggests a framework for **strategic direction and engagement** from government with the primary objective of encouraging more companies to integrate sustainable, responsible business practices into their operations over the medium term. This framework requires six key objectives to advance corporate responsibility responses. The six key objectives are:

- Better coordinate government initiatives
- Demonstration of sustainable, responsible behaviours by government agencies
- Monitor consideration of legitimate environmental and social impacts by directors and trustees
- Support and resource business
- Improve business sustainability reporting
- Better engage the investment sector

1.18 The report below outlines a number of measures and initiatives to support achievement of the key objectives. Developing a full range of measures will require further consultation with the business sector and Labor will continue to do this.

Better coordinate government initiatives

1.19 The Labor committee members believe that in playing a more strategic role, government must provide clear policy direction and ensure that programs related to corporate responsibility are delivered to business in a coordinated and consistent way. It is relatively ineffective for government to develop and deliver policy on corporate responsibility from multiple non-business oriented government departments.

1.20 Additionally, given that many of the initiatives within the framework of corporate responsibility fall within a model of achieving economic, social and environmental sustainability, it is critical for government and the business sector that clear direction is set on the sustainability challenges and risks that face Australia.

1.21 In order to deliver a government approach that is appropriately strategic and coordinated, recommendations are made in the following areas:

- Coordinate management of government corporate responsibility programmes into a Corporate Responsibility and Sustainability Unit in a business oriented government department, for example Treasury or the Department of Industry, Tourism and Resources.
- Establish a National Sustainability Council to define national sustainability objectives.

Coordinated management of government corporate responsibility programmes

1.22 The main committee report referred to evidence that recognised that the current delivery of government corporate responsibility programs occurs in a seemingly uncoordinated fashion amongst a number of government departments. In this regard the Labor members reiterate two quotes from the main report. The Insurance Australia Group submitted:

> Currently, a limited number of government agencies have specific agendas to drive some [corporate responsibility] and related activities. In the Commonwealth, examples include the Department of Environment and Heritage, the Department of Family and Community Services and the Australian Greenhouse Office, which all deliver a variety of programs aimed at providing incentives for corporate responsibility activity.[3]

1.23 A similar comment was made by the Australian Centre for Corporate Social Responsibility:

> The Australian Government may have numerous ways in which it encourages corporate social responsibility, but a lack of coherence and focus of initiatives and policies makes this difficult to ascertain.[4]

1.24 The Labor committee members consider that this fragmented approach from government is inadequate for effective policy formulation and delivery. The Labor committee members believe that an approach such as that taken in the United Kingdom, which has consolidated the government's sustainability initiatives within the Department of Trade and Industry, would be more effective.

1.25 The initiatives outlined in Labor's Supplementary Report, those identified in the main committee report and existing Australian Government programmes would benefit in their development and delivery if consolidated, coordinated and delivered from a cohesive Corporate Responsibility Unit, in a single, business-oriented government department.

1.26 The Labor members note the recommendation in the main committee report regarding a whole-of-government approach, but believe that integration of the policy development and government delivery of corporate responsibility initiatives would best occur within a single department. This is an important part of combining the social (Department of Families, Community Services and Indigenous Affairs (FaCSIA)) and environmental (Department of the Environment and Heritage (DEH) and Australian Greenhouse Office) aspects of policy development as they relate to corporate responsibility with any emerging initiatives in the area of industry and resources as these inevitably develop.

1.27 It is in the interests of business that corporate responsibility initiatives are considered as part of business policy making, and this should occur within a business-oriented government department.

Recommendation 1

The Labor committee members recommend that the Australian Government's various corporate responsibility programs be consolidated in a single, Corporate Responsibility Unit within a business-oriented Australian Government

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3 Insurance Australia Group, *Submission 29*, p. 24.

4 Australian Centre for Corporate Social Responsibility, *Submission 63*, p. 6.

department, for example either the Treasury of the Department of Industry, Tourism and Resources.

A National Sustainability Council

1.28 In the Labor committee members' view, one aspect that was lacking from the corporate responsibility inquiry discussions was any clearly enunciated sustainability targets for Australia. Several submitters also suggested that there should be targets for the level of sustainability reporting, but an official from the Department of the Environment and Heritage indicated that despite lagging other comparable countries the Government has no specific targets.[5]

1.29 It is also necessary to develop policy initiatives and consult closely with the business sector in a regular and open manner. This must occur in a way that enables business and government to openly discuss, identify and contribute to thought leadership in sustainability policy and the formulation of government policy responses. It is the view of the Labor members that a body which draws together business, government and external expertise can best perform these roles.

1.30 In March 2006, the Leader of the Opposition, the Honorable Kim C. Beazley MP, committed a future Labor government to establishing a National Sustainability Council (NSC). One purpose of the NSC would be to recommend Australian sustainability targets to government and then monitor Australia's performance against these targets. The Council could also be responsible for approval of suitable research projects into sustainability and corporate responsibility in Australia.[6]

Recommendation 2

The Labor committee members recommend that the Australian Government establish a National Sustainability Council the roles of which would include:

- **the recommendation of public and private, voluntary Australian sustainability targets and;**
- **monitoring performance levels against these targets.**

Sustainable, responsible government activities

1.31 In order for government to play a strategic leadership role in advancing corporate responsibility, there is a need to strengthen the sustainability performance and reporting framework within government. To date, performance on sustainability objectives has not been demonstrated as a priority of the Howard Government.

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5 Mr Gene McGlynn, Assistant Secretary, Department of the Environment and Heritage, *Committee Hansard*, 27 March 2006, p. 41.

6 This is discussed further below.

1.32 Government agencies are significant users of resources and have a significant impact on the market by virtue of their procurement activities. If governments expect the corporate and non-government sectors to take sustainability objectives more seriously, they must first show leadership.

1.33 The Labor members make an additional recommendation: that mandatory sustainability reporting be performed by government agencies against sustainability targets.

Governments' sustainability practices and performance

1.34 The committee regularly heard that the government should be taking a more active leadership role in order to set a strong example for corporate Australia with its own sustainable and responsible activities. This sentiment is reflected in comments such as the following from the Australian Centre for Corporate Social Responsibility:

> The Australian Federal Government provides endorsement for one aspect of corporate social responsibility through the Prime Minster's Community Business Partnership Awards, and facilitates information about other aspects of corporate social responsibility through the OECD national contact point and some initiatives within the [Department of the Environment and Heritage]. However, these efforts, though laudable, are not sufficient. Further, the Government sends conflicting signals to business about CSR when it supports these activities while at the same time voting against the appointment of a United Nations Special Representative on human rights. The Government must do more to support CSR, and apply a consistent approach.[7]

1.35 During the inquiry the committee explored with DEH officials the sustainability performance of government departments. Several aspects were discussed including procurement practices and environmental management systems.

Government sustainability reporting

1.36 The main committee report found that despite the improved operational performance of the two departments, DEH and FaCSIA, that have voluntarily undertaken sustainability reporting, the rate within government departments is significantly lower than corporate Australia: 3 per cent compared to 23 per cent. DEH officials explained that departments are not influenced by the market to undertake sustainability reporting in the way that corporations are. However, despite this reality, the fact that so few government departments choose to prepare sustainability reports provides a very weak leadership signal to corporate Australia. As an official from DEH acknowledged this diminishes the position of government departments in advocating sustainability reporting:

> ...if we cannot demonstrate that we are acting in a way that is aligned with the position we are taking in the public policy debate our role as policy

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7 Australian Centre for Corporate Social Responsibility, *Submission 63*, p. 2.

> developers, program developers, program implementers and advocates is weakened—and that is something that is acknowledged.[8]

1.37 The Labor members recognise that public sector agencies are still working towards an appropriate, standardised reporting framework, and one that takes account of the multiple disclosures that government departments already make. However, the need not to rush into standardised full sustainability reporting ought be balanced against the need for government agencies to increase their level of reporting and display a leadership role to corporate Australia on reporting practices.

1.38 Rather than recommend mandatory full sustainability reporting by all government agencies, the Labor committee members recommend that the government make agency reporting against the sustainability targets set by the National Sustainability Council a mandatory requirement.

Recommendation 3

The Labor committee members recommend that the Australian Government make reporting against sustainability targets mandatory for Australian government agencies. This reporting should include:

- **Performance against sustainability targets set by the National Sustainability Council regarding water, energy, waste, vehicles, general procurement and any other applicable targets; and**
- **Progress achieved on meeting the targets if they are not met and strategies to enable the meeting of targets in future.**

Monitor consideration of legitimate environmental and social impacts by directors and trustees

1.39 Numerous submitters to the Inquiry stated directors' duties are sufficiently broad to consider the legitimate interests of company stakeholders as well as shareholders. A number of submitters went further to say that it was clearly a requirement for directors to consider legitimate stakeholder interests in the carriage of their duties as directors in Australia.[9] The Labor members note and accept this evidence.

1.40 The Labor members also noted evidence regarding the duties of investment managers and superannuation trustees and their capacity to have regard for environmental and social impacts of their mainstream investment decisions.

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8 Dr Paul Starr, Senior Policy Officer, *Committee Hansard*, 27 March 2006, p. 39.

9 Australian Bankers Association, *Submission 106a*, p. 2

See also: Association of Certified Chartered Accountants, *Submission 32*, p. 4, for UK perspective

1.41 It is with consideration of these issues that additional recommendations are made in the following areas:

- Government to monitor directors' response to their own interpretation of their duties; and
- the Australian Prudential Regulation Authority (APRA) to clarify the scope of the sole purpose test with regard to non-financial risk considerations in all investment decisions.

Directors' duties

1.42 During the Inquiry, company directors and other business representatives clearly stated that responsible directors and executives should have due regard to the impacts of their business operations on stakeholders including communities and the environment. The Labor members endorse this view.

1.43 Much of the discussion about directors' duties in the Inquiry resulted from public comments by the executives of James Hardie Industries and their perception of the scope of directors' duties.[10] These comments portrayed a limited and constrained view of the scope for company directors to consider the interests of stakeholders other than shareholders.

1.44 The interpretation of directors' duties offered by James Hardie executives prompted significant public debate and evidence to the committee. Most of this evidence included a clear rejection of the notion that directors' duties under Australian law prevent directors from taking into account and addressing the social and environmental impacts of their business as long as this consideration is undertaken in the interests of the corporation.

1.45 This has in effect been an emphatic endorsement of the 'enlightened self interest' interpretation of directors' duties which is outlined in the main committee report. While this committee cannot make a definitive determination as to the legal parameters of existing directors' duties in practice, Labor welcomes the 'enlightened self interest' interpretation of directors' duties put forward by a range of business and legal witnesses. We hope such an interpretation is representative of the understanding and practical exercise of directors' duties in future.

1.46 Labor members also note that business leaders and business lawyers, having stated their position on the scope of directors' duties have a responsibility to put this interpretation into action in coming years. If there was to be a recurrence of the view from the business sector that directors duties prevented attention to legitimate stakeholder interests, government would be forced to immediately review the articulation of directors' duties and ensure that no such misunderstanding were possible.

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10 Fiona Buffini, 'Calls to protect corporate conscience', *Australian Financial Review*, 23 November 2005, p. 4.

1.47 Therefore it is the view of Labor members, given the evidence to the committee regarding directors' duties and in the absence of any clear, recent court interpretation of directors' duties with regard to stakeholder interests, that there is no need to vary those duties in the short term. Director duties are already broad enough and include an obligation to consider stakeholder and non-financial risk issues when acting in the best interests of the company.

Recommendation 4

The Labor committee members do not recommend any alternative to the current formulation of directors' duties. However, if legal barriers to the consideration of legitimate environmental and social issues by directors are subsequently raised, either by judicial interpretation or in practice, this matter would require reconsideration by government.

Sole purpose test

1.48 The main committee report refers to evidence of the Financial Services Institute of Australasia (Finsia) regarding the sole purpose test with respect to Sustainable Responsible Investments (SRI), and makes Recommendation 2 with regard to APRA guidance on the scope of the sole purpose test.

1.49 There was some debate during the Inquiry about whether the sole purpose test for investment trustees and fund managers was broad enough to allow them to consider non-financial risks, or so called Environment, Social and Governance risks (ESG) in investment decisions. Evidence from Finsia to the Inquiry was that the sole purpose test is broad enough to allow consideration of non-financial risk issues in investment decisions as long as the strategy is employed as means to maximise the retirement funds of members, and not pursued as an end in itself.[11]

1.50 While the evidence from Finsia identifies that fund managers and trustees may consider SRI type investments as part of this strategy, it does not suggest that fund managers and trustees may only exercise this approach via SRI funds. As such the recommendation of the main committee which focuses on only SRI funds, fails to grasp the issue relating to ESG based investment decisions.

1.51 If the sole purpose test is broad enough to allow consideration of ESG risks, it ought to permit considerations of these risks in the context of all mainstream investment decisions considered appropriate by the trustee or fund manager. Consideration of non-financial risk is fundamentally relevant to execution of the fiduciary duty.

1.52 Linking the sole purpose test solely with the allocation of funds to SRIs represents a fundamental misunderstanding of the need for investment managers to consider sustainability factors in **<u>all</u>** investment decisions.

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[11] Financial Services Institute of Australasia, *Submission 146*, p. 9.

1.53 Labor members believe an alternative formulation of Recommendation 2 from the main committee report is necessary. APRA should provide clarification to superannuation trustees that they may consider environmental, social and governance factors as potential risks to investment returns which are consistent with the making of all investment decisions under the sole purpose test. Clarification of this in detailed guidelines on the sole purpose test by APRA is warranted.

Recommendation 5

The Labor committee members recommend that the Australian Prudential and Regulation Authority issue detailed guidelines on the sole purpose test to clarify the ability of superannuation trustees and fund managers to evaluate non-financial risk and return in all investment decisions.

Support and resource business

1.54 An effective strategic leadership role requires that government focus on its own organisational strengths to advance corporate responsibility in Australia. Strengths of government include policy development, research and design and resourcing of programmes. For this reason, government should focus on these roles in facilitating greater uptake of sustainable business.

1.55 The Labor members advocate for the improvement of sustainability performance and reporting via the provision of support mechanisms and resources to businesses. The Labor members note a number of constructive recommendations from the main committee, including the establishment of the Australian Corporate Responsibility Network, which should provide an effective mechanism to complement and coordinate where necessary, the efforts of businesses to execute on their corporate responsibility and sustainability strategies.

1.56 Beyond the main committee recommendations, the Labor members note that several witnesses to the Inquiry identified the importance of allowing for innovation and individual responses to the question of how best to integrate corporate responsibility approaches. Labor members accept this feedback and make recommendations that will build capacity of corporate staff and encourage the development of individual responses. Accordingly, the Labor committee members make several additional recommendations in the following areas:

- Provide capacity building tools to companies;
- Remove government barriers to responsible corporate behaviour; and
- Endorse and provide guidance on international initiatives.

Capacity building tools for companies

1.57 Evidence to the committee indicated that the Global Reporting Initiative is considered by many in business to be a significant undertaking and that getting started on implementing corporate responsibility frameworks and reporting within a business was a difficult step.

1.58 The Labor members recognise it can be difficult for companies when starting to integrate sustainable practices and suggest there should be a clear and relatively manageable interim step for companies to take.

1.59 The committee noted the importance of the Credit Union CSR Toolkit developed by the Credit Union Foundation Australia (CUFA). This tool is an accessible and cost effective instrument to allow credit unions to more effectively plan and report on their CSR activities. It can also be used by other small to medium enterprises.

1.60 The committee also noted the *Arcturus* corporate responsibility risk assessment and behavioural inventory assessment tool developed by the Caux Round Table (CRT), and supported its further examination. With forty-nine assessment criteria, *Arcturus* is said to be sufficiently flexible to apply to companies across the diverse Australian market. It could be a low cost mechanism to encourage first time participants to engage in the voluntary adoption of good governance and corporate responsibility practices and to benchmark their performance against sector or industry-wide benchmarks.

1.61 Labor believes that either the CUFA initiative or CRT's *Arcturus*, could be used as a capacity building tool with widespread application. In the case of the CUFA initiative, it could be used as a model for use in other sectors. There may also be other tools already in use that were not brought to the committee's attention.

1.62 Labor supports the development of a flexible sector-specific tool to enable different industries to plan and adopt corporate responsibility activities. Such a tool should be low cost and compatible with international initiatives such as the GRI Framework. Labor believes that the government should play a coordinating role to set up a standard framework and then to assist various sectors to modify the framework to suit their own needs. Any framework should be developed with a view to meeting the needs of financial analysts so that the sustainability information produced can be easily used by financial markets.

Recommendation 6

The Labor committee members recommend that the Australian Government, in consultation with industry and using an existing tool as a model if appropriate, develop a widely applicable corporate responsibility capacity building tool to provide an interim step for companies wanting to integrate corporate responsibility activities into their operations.

Remove government barriers to responsible corporate behaviour

1.63 The main committee report recognises that submitters raised various financial incentives and regulation that either encourage or discourage corporate responsibility. The committee report provides the example of the capital gains tax arrangements applying to the sale of shares and mentions the fringe benefits tax on fleet vehicles. Other disincentives cited in evidence include the:

- tax treatment of providing child care[12]
- insurance and OH&S issues for corporate volunteering[13]
- tax treatment of superannuation which encourages those nearing retirement age not to extend their life of work[14]
- tax treatment of plant maintenance versus new capital investment[15]
- subsidies that encourage the use of fossil fuels[16]

1.64 Submitters also referred to new incentives including:

- Promoting research and development into innovative corporate responsibility partnerships[17]
- a carbon tax or an emissions trading scheme[18]
- a fee on plastic bags[19] and
- container deposit legislation[20]

1.65 Several submitters suggested a review of existing government regulations as well as tax and spending policies, with the aim of enabling and encouraging greater social investment and investigation of their environmental and social consequences.[21]

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12 Mr Steven Muchenberg, Business Council of Australia, *Committee* Hansard, 23 February 2006, pp 104–105.

13 Mr Steven Muchenberg, Business Council of Australia, *Committee Hansard*, 23 February 2006, p. 105.

14 Ms Sam Mostyn, Group Executive, Culture and Reputation, Insurance Australia Group, *Committee Hansard*, 9 March 2006, p. 18.

15 Mr Charles Berger, Legal Adviser, Australian Conservation Foundation, *Committee Hansard*, 24 February 2006, p. 83.

16 Mr Charles Berger, Legal Adviser, Australian Conservation Foundation, *Committee Hansard*, 24 February 2006, p. 84.

17 The Body Shop, S*ubmission 42*, p. 5.

18 Mr Wayne Gumley, Senior Lecturer, Department of Business Law and Taxation, Monash University, *Committee Hansard*, 24 February 2006, p. 60; and Mr Murray Hogarth, Senior Associate, Ecos Corporation, *Committee Hansard*, 9 March 2006, p. 71.

19 Mr Wayne Gumley, Senior Lecturer, Department of Business Law and Taxation, Monash University, *Committee Hansard*, 24 February 2006, p. 60.

20 Mr Murray Hogarth, Senior Associate, Ecos Corporation, *Committee Hansard*, 9 March 2006, p. 71.

21 For example Mr Steven Muchenberg, Business Council of Australia, *Committee Hansard*, 23 February 2006, p. 105; Insurance Australia Group, *Supplementary Submission 29a*, p. 3; Mr Charles Berger, Australian Conservation Foundation, *Committee Hansard*, 24 February 2006, p. 84; and Philanthropy Australia, *Submission 23*, p. 4.

1.66 Labor members believe that a thorough investigation of policy arrangements is necessary and recommend that an audit of policies and regulations affecting sustainability and corporate responsibility activities by business be conducted.

1.67 The Labor members also support an investigation of possible regulatory relief for companies that display committed performance on sustainability targets and corporate responsibility. This suggestion was raised in evidence to the committee and referred to in the main committee report.

Recommendation 7

The Labor committee members recommend that the Australian Government undertake an audit of government regulations and financial arrangements that encourage or discourage sustainable business practices.

Endorse and provide guidance on international initiatives

1.68 The Labor committee members support the committee's recommendations regarding the Global Reporting Initiative and the UN Principles for Responsible Investment and the Global Compact. The Labor members would also like to pay particular attention to the OECD Guidelines on Multinational Enterprises and the OECD Anti-Bribery Convention.

OECD multinational enterprises guidelines

1.69 The Labor committee members support the OECD Guidelines for Multinational Enterprises. Although this policy instrument has, until recently, not been used in Australia, the example cited in the main committee report of the mediated outcome involving Global Solutions Limited Australia, demonstrates its potential effectiveness if it were to be used more frequently.

1.70 As referred to in the main committee report, the 'specific instance mechanism' under the OECD Guidelines is one that allows corporations and stakeholder groups an avenue for mediated resolution of disputes relating to a multinational company's performance under the OECD guidelines. This is a process that can be constructive for both multi-national enterprises and stakeholder groups.

1.71 The Labor committee members reiterate the evidence of the Treasury referred to in the main committee report: "...governments adhering to the OECD guidelines are committed […] to promoting the guidelines..."[22] In the Labor committee members' view, the fact that the 'specific instance' review has only been successfully used once in Australia, demonstrates that the government's promotion of these guidelines has been of limited effect. The specific instance mechanism is a constructive model for engagement between stakeholders and companies and should be utilised by these groups whenever necessary.

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22 Department of the Treasury, *Submission 134*, p. 11.

Recommendation 8

The Labor committee members recommend that the Australian Government more actively promote the OECD Multinational Enterprises Guidelines to Australian corporations.

OECD Anti-Bribery Convention

1.72 The main committee report identified that the proportion of corporate codes of conduct on bribery and corruption in Australia was much lower than the United States and the United Kingdom. For example the Centre for Australian Ethical Research recently found that only 51 of the top 100 companies in Australia had policies in place to prohibit the payment and receipt of bribes, which compares with 92 per cent in the UK, 80 per cent in the US and 91 per cent in Europe.[23]

1.73 This may indicate a lower level of awareness of the effects that supporting corruption and the payment of bribes in particular can cause for societies, including undermining democracy and the rule of law, distorting markets, impeding international trade and the facilitation of organised crime.[24]

1.74 Australian companies have obligations under Australian law regarding the giving and receiving of bribes. Australia's *Bribery of Foreign Public Officials Act 1999* enacts many of our obligations under the OECD Anti-Bribery Convention. However the OECD has expressed a number of concerns regarding Australia's implementation of the Anti-Bribery Convention. The Howard Government's approach has left gaps in Australia's Criminal Code which in turn lowers the behaviour benchmark for Australian companies operating internationally. The option to classify a payment to a foreign official as a facilitation payment is one such example that the OECD points to in its January 2006 recommendations to Australia.

1.75 The Labor members are of the view that it is desirable for more Australian companies operating overseas to develop their own codes of conduct on corruption and bribery. Greater promotion of Australia's obligations under the UN Convention Against Corruption, and the OECD Anti-Bribery Convention would help in this regard.

1.76 The Labor members note recent public comments by the Minister for Justice and Customs, Mr Chris Ellison MP, regarding bribery of overseas officials, and encourage the government to continue this overdue promotion of Anti-Bribery laws.

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23 Centre for Australian Ethical Research, Just how is business done? *A review of Australian business' approach to bribery and corruption*, March 2006, p.3

24 United Nations Convention Against Corruption, (New York, 31 October 2003) [2003] ATNIF 21.

Recommendation 9

The Labor committee members recommend that the Australian Government widely promote the terms and Australia's obligations under the UN Convention Against Corruption and the OECD Anti-Bribery Convention, and encourage more Australian companies to develop their own codes of conduct against bribery and corruption.

Improve business sustainability reporting

1.77 The Labor members believe that adequate and appropriate reporting on sustainability issues and non-financial risk is a key element of improving sustainability performance.

1.78 Given that there are currently serious deficiencies in the quality of material non-financial information being provided to investors, encouraging improved sustainability reporting should be a key government objective.

1.79 The Labor members accept that there is a steady process to be followed by companies as they build the capacity to identify, report on and act on sustainability information within a business. Rather than requiring all companies to perform detailed sustainability reporting in the short term, it is therefore necessary to allow companies to follow this process at their own pace.

1.80 It is also important that all large companies start on the process of collecting and using information on the sustainability performance of their businesses. As such, the Labor members consider that a minimum of non-financial risk or sustainability reporting should eventually be performed by every company that is a 'large' company under the *Corporations Act 2001*. This recommendation is discussed further below.

1.81 Beyond any mandatory minimum requirement, it is also important that for listed companies, the level and depth of non-financial risk assessment and disclosure by companies increase over the medium term.

1.82 Additional recommendations to those in the main report are made in the following areas to improve sustainability reporting by business:

- Ensure a flexible, mandatory minimum of sustainability reporting by all large and listed companies;
- Set targets for rates of detailed sustainability reporting by listed companies; and
- ASIC to monitor the quality and usefulness of sustainability disclosures by listed companies under the Operating and Financial Review.

1.83 Before detailing these specific areas where the Labor members believe the main committee report should have gone further, some general comments are made on sustainability reporting.

The need for non-financial reporting

1.84 Evidence to the committee clearly identified a need to increase the quality and quantity of reporting on non-financial risks, with some submitters identifying areas for mandatory reporting by companies. For example AMP Capital Investors identified a need for companies to report the main trends and factors they were likely to address in future development, as well as information about non-compliance with the law, occupational health and safety performance, greenhouse gas emissions and political donations.[25]

1.85 The Association of Certified Chartered Accountants (ACCA) noted the global trend toward increased management commentary or narrative reporting, including discussion of business risks including climate change, human rights, supply chain management and bribery and corruption.[26] ACCA also noted the current move to modify international accounting standards to include such reporting obligations. Given these trends Labor members are of the view that the capacity to interpret, prepare organisational data and report on sustainability challenges and non-financial risks is of critical importance to Australian business.

Forward looking information

1.86 Sustainability reports will often have a forward looking aspect as well as outlining past company performance. The indicators used in sustainability reporting are often referred to as "lead indictors" as compared with the "lag indicator" contained in quarterly financial reports. For this reason some companies and observers suggest that reporting against sustainability indicators provides a better picture than financial results of how a company will perform in the future. In its recent report on sustainability reporting, the Centre for Australian Ethical Research gave the following example:

> An executive of one of Australia's largest companies stated recently, in an article directed at CFOs, that a company's financial results are "lag indicators", reflecting what the company has done over the past reporting period, while the items generally reported under "sustainability" are the "leading indicators" of how well the company is dealing with its future risks. "I'd like to see the language change so that CFOs think differently about what is a lead indicator and what is a lag indicator. Anyone relying purely on a 12-month financial report is making a judgement without fully considering the quality of the company's management. Sustainability reporting is more complex, and so if it is done successfully, it shows how well the company is being run."[27]

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25 AMP Capital Investors, *Submission 30*, p. 2

26 Association of Certified Chartered Accountants, *Submission 32*, p. 9

27 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 7.

1.87 The GRI Guidelines for example encourage reporting organisations to highlight future trends by presenting:

> ...information for all performance indicators in a manner that enables users to understand current and future trends. At a minimum, reporting organisations should present data for the current reporting period (e.g., one year) and at least two previous periods, as well as future targets where they have been established.[28]

1.88 Labor notes evidence received by the committee about the potential risks to directors of litigation from making forward looking statements about the company's prospects.[29] While recognising that some directors may have these concerns, the Labor members also note that there is not a history of litigation in Australia against company directors in relation to corporate disclosures. There is certainly an obligation to report in good faith under directors duties but there is no clear liability for being incorrect, so long as disclosures are made in good faith.

1.89 None-the-less, considering the evidence received by the committee and concerns about the prospect of directors being exposed to litigation, the Labor members take the view that if there proved to be a material risk resulting from the provision of forward looking, non-financial information to the market, the parliament would rightly enact appropriate protection from liability for company directors. This is a situation that should be monitored by the parliament and business groups to ensure that no undue pressure or misinterpretation of the duties of company directors develops to deter directors from making adequate disclosures under the *Corporations Act 2001* or other mechanisms.

A mandatory minimum of reporting on non-financial risk

1.90 The Labor committee members support Recommendation 10 in the main committee report, concerning the identification and disclosure of the material non-financial aspects of the risk profile of large listed companies by disclosure of their top five sustainability risks, and providing information on the strategies to manage such risks.

1.91 However in the view of Labor committee members it is appropriate and in the public interest for this recommendation to apply beyond large listed public companies. The principle that disclosure requirements should apply more broadly was shared by submitters such as the Commercial Law Association and the Australian Conservation Foundation.[30] It should apply to all large companies operating in Australia whose activities have significant environmental or social impacts, regardless of their

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28 Global Reporting Initiative, *Sustainability Reporting Guidelines*, 2002, p. 34.

29 Australian Bankers Association, *Submission 106 a*, p. 2.

30 Mr Daren Armstrong, Secretary, Legislative Review Task Force, Commercial Law Association of Australia Limited, *Committee Hansard*, 23 November 2005, p. 13; and Australian Conservation Foundation, *Submission 21*, p. 34.

corporate categorisation. That is it should apply to all large listed public, unlisted public, and private companies.

1.92 As this broader recommendation is beyond the purview of the Australian Stock Exchange (ASX), it is more appropriate to be introduced as an amendment to the *Corporations Act 2001*. However, in keeping with the flexibility provided by the ASX Council Recommendations it should be introduced using the 'if not, why not' reporting mechanism. Suitable arrangements should be made to ensure that disclosures made by unlisted companies are made publicly available.

1.93 Furthermore, a transitional company size threshold should be set. This would ensure a focus on those companies with typically the greatest financial and resource capacity, and potentially those with the greatest social and environmental impacts.

1.94 The Labor members note the current dialogue between the business sector and government regarding appropriate thresholds for the definition of 'large company' under the Corporations Act. It is the view of the Labor members that current thresholds identifying companies as large under the Corporations Act may be too low for this to be the threshold for this proposed reporting requirement. However an increase in the thresholds would address this situation. Labor will monitor developments in this area.

1.95 For listed companies, it may be appropriate for this requirement to be addressed within section 299A of the *Corporations Act 2001*, while for non-listed large companies, a further provision would be necessary. It may also be necessary to provide guidance to non-listed companies on the range of non-financial or sustainability issues they should consider, such as water use, waste, emissions, on an if-not, why not basis. Guidance from the Treasury would be necessary on the most appropriate way to create this provision in the *Corporations Act 2001*.

Recommendation 10

The Labor committee members recommend an amendment to the *Corporations Act 2001* to require all public and private companies, operating in Australia and above a specified size threshold, to publicly disclose their top five sustainability risks and their strategies to manage such risks. This provision should be subject to an 'if not, why not' flexibility mechanism modelled on that contained in the Australian Stock Exchange Corporate Governance Council's Principles of Good Corporate Governance.

Sustainability reporting targets

1.96 Beyond the proposed flexible, mandatory minimum disclosure of sustainability risks for all large companies, the Labor members believe it is desirable to increase the rate of detailed sustainability reporting by large companies and especially large listed companies.

1.97 The committee heard from officials from the Department of the Environment and Heritage that despite the low rate of sustainability reporting in Australia (around half the OECD average) the Government has:

> No specific targets. There is a comparison with other countries and by implication there is an indication that we are not at a level as high as those in many of those other countries. But there is no specific target...
>
> ...I think there is a general sense that the take-up of reporting and the quality of reporting in Australia is not at the level that we would like to see...[31]

1.98 The Labor committee members believe that without a clear government and business agreement regarding expectations for the level of sustainability reporting it is not unsurprising that the rate in Australia is low.

1.99 The Labor committee members are concerned that it is expected to take until 2035 for all of the top 500 companies to be preparing sustainability information, as suggested in the main committee report. In the Labor members' view this is disappointingly slow. If Australia is to take advantage of future financial opportunities that will increasingly flow from improved social and environmental performance, the rate of engagement and disclosure in this area needs to be higher.

1.100 The Labor members would like to see the rate of reporting in Australia's largest companies increase dramatically over the next five to ten years. The Labor committee members have already recommended the development of a capacity building framework which should make it easier for companies to plan and undertake sustainability reporting for the first time.

1.101 The Labor committee members would expect that the rate of detailed sustainability reporting in Australia will improve dramatically with these initiatives. Labor members support a phased approach similar to that suggested by Corporate ResponseAbility.[32] Labor members believe a realistic timeframe, but one that should be negotiated and agreed with business representatives is:

- 90 per cent of ASX 100 companies by 2010;
- 90 per cent of ASX 200 companies by 2012;
- 90 per cent of ASX 300 companies by 2014; and
- 90 per cent of ASX 500 companies by 2016.

1.102 The Labor committee members believe that with the level of support and resourcing being proposed in Labor's recommendations, and with the transitional period indicated, these targets should be achievable. Corporations will also have a

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31 Mr Gene McGlynn, Assistant Secretary, Department of the Environment and Heritage, *Committee Hansard*, 27 March 2006, p. 41.

32 Corporate ResponseAbility, *Submission 93*, p. 8.

reasonable period of time to integrate principles of corporate responsibility into their core operations. If by these timeframes sustainability reporting is not reaching, or is not near these levels, the Labor committee members believe that other policy alternatives including the question of mandatory sustainability reporting should be considered.

Recommendation 11

The Labor committee members recommend that the Australian Government make a clear policy statement setting out stepped targets with clear timelines for the uptake of detailed sustainability reporting in Australia.

Utilising the Operations and Financial Review

1.103 There are various existing regulatory and market-based arrangements that were recognised in the main committee report as having the potential to accommodate non-financial disclosures including the 'Additional general requirements for listed public companies' in the annual directors' report, which is set out in section 299A of the *Corporations Act 2001*. This is sometimes called the Operations and Financial Review or OFR.

1.104 The main committee report recognised the significant potential of the OFR to promote material non-financial disclosures. The Labor members note that it may be appropriate for listed companies to use this section to disclose their top five sustainability risks and their strategies to mitigate them.

1.105 The Labor committee members believe the non-financial disclosures that result from the OFR should be closely monitored to ensure the disclosures are meeting the evolving needs of shareholders and the wider capital market to assess and value material non-financial performance and risk management strategies. In its role as disclosure regulator, the Australian Securities and Investment Commission (ASIC) is the appropriate organisation to undertake such monitoring.

1.106 Labor committee members note that the OFR only applies to listed public companies, and that disclosures made under section 299A may in future exceed the minimum mandatory requirement to disclose the company's top five sustainability risks.

1.107 The Labor members also note and agree with the main committee's report for auditors to review the non-financial disclosures in the OFR and to make recommendations to the company board about the adequacy of these disclosures. But given that OFR disclosures are still developing as a framework for non-financial disclosures and that Labor members have recommended a flexible, mandatory minimum disclosure of the top five sustainability risks under the corporations law, it is appropriate for ASIC to play an oversight role on the adequacy and usefulness of disclosures made therein.

1.108 The Labor members make a recommendation to that effect, complementary to the recommendation in the main report regarding the role of company auditors and the oversight of disclosures under the OFR.

Recommendation 12

The Labor committee members recommend that on an annual basis the Australian Securities and Investment Commission:

- **review the extent to which companies are making non-financial disclosures in their report on Operations and Financial Review;**
- **make recommendations to the Australian Government regarding the adequacy of the disclosures to meet the evolving needs of shareholders, and the wider capital market to assess and value material non-financial performance, risk profile and risk management strategies; and**
- **present a copy of the review and recommendations to parliament.**

Better engage the investment sector

1.109 Labor has consistently taken the view that active engagement by institutional investors and fund managers in the governance of investee companies is a critical mechanism for ensuring good oversight and governance of those companies. This is because the modern reality is that intermediaries now control the ownership rights of most shareholders and if a passive approach to exercising these is taken, companies can lose touch with the expectations and interests of their individual owners and the public. Following a passive investment approach is clearly contrary to the broader objective of ensuring greater consideration of stakeholder needs.

1.110 This view on the role of fiduciaries was very effectively articulated by Justice Neville Owen in Chapter 6.3 of the HIH Royal Commission report:

> Shareholder apathy can play a part in undesirable corporate governance. If shareholders as owners are unwilling or unable to exercise their powers or make themselves heard, directors and management will lack guidance or constraint from those whose interests they are supposed to serve. Shareholders have an interest in seeing that a board is properly constituted and in holding it to account for the company's performance.
>
> There is an opportunity for institutions and especially managed funds to take a lead.[33]

1.111 In consideration of non-financial risks in investment decisions, there is a clear need for the investment sector to more actively seek useful non-financial reporting information from investee companies. If there is to be significant progress in the area

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33 Report of the HIH Royal Commission, Chapter 6.3

of sustainable business performance, the requirements of investors, 'pulling through' the non-financial data they require will be a critically important driver of change.

1.112 The committee heard evidence of the progress being made internationally from Amanda McCluskey from Portfolio Partners;

> Internationally, we have seen the formation of the enhanced analytics initiative. This is an initiative with a number of UK and European based fund managers that have committed to allocate five per cent of their brokerage to brokers who produce research that adds value over the long term, especially on areas relating to sustainability. [...] That has seen the formation of ESG units in brokerage houses including Goldman Sachs, Credit Suisse First Boston and UBS Warburg. These are not your typical fringe green, fluffy type names. These are mainstream investment banks that have employed people specifically to look at sustainability issues and how they impact on company performance.[34]

1.113 To the Labor members, this approach from fund managers and the brokerage houses that serve them appears to be an innovative response to the challenge of ensuring useful non-financial data is available, and is one that is instructive for Australian companies.

1.114 Regarding progress in Australia, the Labor members wish to recognise the submission of Finsia to the Inquiry regarding the integration of Environmental, Social and Governance (ESG) considerations into investment decisions. This type of research fills an important gap in the policy making landscape in Australia on how to encourage and enable investors to actively assess non-financial risk. Extension of this research programme would provide a further constructive contribution to the development of non-financial reporting and analysis in Australia.

1.115 It is clear to the Labor members that at this stage the value given to and use of non-financial data by traditional market analysts and fund managers is too low. Labor believes that the National Sustainability Council referred to in earlier recommendations could successfully auspice further research or education activities and engage with industry groups such as Finsia as they perform their own further research. The necessary funding from government for such research is referred to in the main committee report at Recommendation 23.

1.116 The Labor members also note and support the main committee's endorsement of the UN Guidelines on Responsible Investment and would encourage Australian investment institutions to formally endorse the principles as well.

Recommendation 13

The Labor committee members recommend that the National Sustainability Council engage with the investment sector to identify areas of research,

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34 Ms Amanda McCluskey, Portfolio Partners, *Committee Hansard*, 5 April 2006, p.69

education and reporting needs that would assist institutional investors and trustees to better identify and assess non-financial risks and investment opportunities.

Ms Anna Burke MP

Deputy Chair

Mr Chris Bowen MP

Senator Nick Sherry

Senator Penny Wong

Appendix 1: Summary of Labor members' recommendations

Recommendation 1

The Labor committee members recommend that the Australian Government's various corporate responsibility programs be consolidated in a single, Corporate Responsibility Unit within a business oriented Australian Government department, for example either the Treasury of the Department of Industry, Tourism and Resources.

Recommendation 2

The Labor committee members recommend that the Australian Government establish a National Sustainability Council the roles of which would include:

- **The recommendation of public and private, voluntary Australian sustainability targets**
- **Monitoring performance levels against these targets**

Recommendation 3

The Labor committee members recommend that the Australian Government make reporting against sustainability targets mandatory for Australian government agencies. This reporting should include:

- **Performance against sustainability targets set by the National Sustainability Council regarding water, energy, waste, vehicles, general procurement and any other applicable targets**
- **Progress achieved on meeting the targets if they are not met and strategies to enable the meeting of targets in future**

Recommendation 4

The Labor committee members do not recommend any alternative to the current formulation of directors' duties. However, if legal barriers to the consideration of legitimate environmental and social issues by directors are subsequently raised, either by judicial interpretation or in practice, this matter would require reconsideration by government.

Recommendation 5

The Labor committee members recommend that the Australian Prudential and Regulation Authority issue detailed guidelines on the sole purpose test to clarify

for superannuation trustees and fund managers their position in relation to allocating member funds in all investment decisions.

Recommendation 6

The Labor committee members recommend that the Australian Government, in consultation with industry and using an existing tool as a model if appropriate, develop a widely applicable corporate responsibility capacity building tool to provide an interim step for companies wanting to integrate corporate responsibility activities into their operations.

Recommendation 7

The Labor committee members recommend that the Australian Government undertake an audit of government regulations and financial arrangements that encourage or discourage corporate responsibility activities.

Recommendation 8

The Labor committee members recommend that the Australian Government more actively promote the OECD Multinational Enterprises Guidelines to Australian corporations.

Recommendation 9

The Labor committee members recommend that the Australian Government widely promote the terms and Australia's obligations under the UN Convention Against Corruption and the OECD Anti-Bribery Convention, and encourage more Australian companies to develop their own codes of conduct against bribery and corruption.

Recommendation 10

The Labor committee members recommend an amendment to the *Corporations Act 2001* to require all public and private companies, operating in Australia and above a specified size threshold, to publicly disclose their top five sustainability risks and their strategies to manage such risks. This provision should be subject to an 'if not, why not' flexibility mechanism modelled on that contained in the Australian Stock Exchange Corporate Governance Council's Principles of Good Corporate Governance.

Recommendation 11

The Labor committee members recommend that the Australian Government make a clear policy statement setting out stepped targets with clear timelines for the uptake of detailed sustainability reporting in Australia.

Recommendation 12

The Labor committee members recommend that on an annual basis, the Australian Securities and Investment Commission:

- **Review the extent to which companies are making non-financial disclosures in their report on Operations and Financial Review**
- **Make recommendations to the Australian Government regarding the adequacy of the disclosures to meet the evolving needs of shareholders, and the wider capital market to assess and value material non-financial performance, risk profile and risk management strategies**
- **Present a copy of the review and recommendations to parliament**

Recommendation 13

The Labor committee members recommend that the National Sustainability Council engage with the investment sector to identify areas of research, education and reporting needs that would assist institutional investors and trustees to better identify and assess non-financial risks and investment opportunities.

Appendix 2: Labor position on main committee recommendations

Main committee recommendation	Labor members' position
Recommendation 1	
The committee finds that the *Corporations Act 2001* permits directors to have regard for the interests of stakeholders other than shareholders, and recommends that amendment to the directors' duties provisions within the Corporations Act is not required.	Agree in principle. See Labor recommendation 4.
Recommendation 2	
That the Australian Prudential Regulation Authority issue detailed guidelines on the sole purpose test to clarify for superannuation trustees their position in relation to allocating investments to sustainable responsible investment fund managers.	Disagree. Evidence to the committee also considered mainstream investment decisions. See Labor recommendation 5.
Recommendation 3	
The committee recommends that institutional investors in Australia seriously consider becoming signatories to the United Nations Principles for Responsible Investment.	Agree.
Recommendation 4	
The committee recommends that the Future Fund should become a signatory to the United Nations Principles for Responsible Investment.	Agree.
Recommendation 5	
The committee recommends that sustainability reporting in Australia should remain voluntary.	Agree in part. All companies passing the large company test should in time, provide a minimum mandatory level of reporting on their key sustainability risks. See Labor recommendation 10.

Recommendation 6	
The committee recommends that the Australian Government, through the Joint Environment Protection and Heritage Council / Ministerial Council on Energy Policy Working Group process, seek to rationalise Australia's greenhouse and energy reporting requirements into a national framework.	Agree
Recommendation 7	
The committee recommends that government and industry should liaise on developing a mechanism for setting sectoral benchmarks for greenhouse and energy performance.	Agree in principle. The Labor members believe the National Sustainability Council should perform this role and should also set other sustainability targets as necessary. See Labor recommendation 2.
Recommendation 8	
The committee recommends that each company auditor on an annual basis: • review the extent to which companies are making non-financial disclosures in their Operating and Financial Reviews; and • make recommendations to the company Board regarding the adequacy of the disclosures to meet the evolving needs of shareholders, and the wider capital market in order to assess and value material non financial performance, risk profile and risk management strategies.	Agree in principle. Labor members believe it is also important for ASIC to play a role in monitoring non-financial disclosures and especially those included in the OFR. See Labor recommendation 12.
Recommendation 9	
The committee recommends that: • it is premature to adopt the Global Reporting Initiative Framework as the voluntary Australian sustainability reporting framework; and • that the Australian Government continue to monitor the acceptance and uptake of the Global Reporting Initiative Framework, both nationally and internationally, with a view to its suitability as the, or a basis for a, voluntary Australian	Agree.

sustainability reporting framework.	
Recommendation 10	
The committee recommends that the Australian Stock Exchange Corporate Governance Council (ASX Council) provide further guidance to Principle 7 of the ASX Council's *Principles of Good Corporate Governance and Best Practice Recommendations* to the effect that companies should inform investors of the material non-financial aspects of a company's risk profile by disclosing their top five sustainability risks; and providing information on the strategies to manage such risks.	Disagree. Labor recommends there be a flexible mandatory minimum reporting requirement under the *Corporations Act* on a company's top five sustainability risks. See Labor recommendation 10.
Recommendation 11	
The committee recommends that the ASX Council undertake industry consultation to determine whether there are areas where companies, investors, and other stakeholders believe further guidance is necessary in relation to the non-financial disclosure requirements under the ASX Council's *Principles of Good Corporate Governance and Best Practice Recommendations.*	Agree.
Recommendation 12	
The committee recommends that the Australian Securities and Investments Commission revise the *Section 1013DA disclosure guidelines* to be relevant to mainstream fund managers rather than simply to the more limited pool of ethical investment funds.	Agree.
Recommendation 13	
The committee recommends that the Australian Government provide seed funding to establish an organisation, the Australian Corporate Responsibility Network, to be modelled on the United Kingdom initiative Business in the Community.	Agree. Support for this type of organisation should recognise the many initiatives that exist in Australia and provide a mechanism to coordinate and where necessary, compliment these initiatives. The Australian Corporate Responsibility Network could also contribute to and help business to execute sustainability objectives

	defined by the National Sustainability Council.
Recommendation 14	
The committee recommends that investors, stakeholders and relevant business associations should encourage companies to include long term and corporate responsibility performance measures as part of the remuneration packages of company directors, executive officers and managers.	Agree.
Recommendation 15	
The committee recommends that industry associations and peak bodies proactively promote to their members the benefits of corporate responsibility, and encourage greater engagement by their members.	Agree. Government or the Australian Corporate Responsibility Network must be capable of providing best practice and other information on corporate responsibility to peak organisations intending to develop their capacity in this area.
Recommendation 16	
The committee recommends that the Australian Stock Exchange, in consultation with companies, institutional investors and rating agencies, establish and operate a central web-based tool for the dissemination of sustainability information, based on the London Stock Exchange's Corporate Responsibility Exchange. The Australian Government should consider whether seed funding is required to establish such a service.	Agree.
Recommendation 17	
The committee recommends that the proposed Australian Corporate Responsibility Network publicise and promote best practice examples across the spectrum of corporate responsibility activities and across industry sectors.	Agree.
Recommendation 18	
The committee recommends that the not-for-profit sector should endeavour to meet the same standards as the for-profit sector in	Agree.

considering the interests of stakeholders.	
Recommendation 19	
The committee recommends that the Prime Minister's Community Business Partnership continue to move beyond its initial focus on philanthropy, towards a broader sustainability framework.	Agree in principle. The current Business Community partnerships program should develop new categories of award to recognise the full spectrum of corporate responsibility activities, and should be incorporated into the corporate responsibility unit within a single business oriented government department. See Labor recommendation 1.
Recommendation 20	
The committee recommends that, in order to show greater leadership and to encourage more agencies to disclose their sustainability performance, the Australian Government establish: • voluntary sustainability reporting targets for government agencies • voluntary targets for government agency procurement in areas such as water, waste, energy, vehicles, equipment and consumables, and; • a requirement for each government agency to disclose such targets and to detail progress towards achieving these in its annual report	Disagree. Labor believes that current voluntary programs initiated by the government have not encouraged departments to take sustainability reporting seriously. This level of commitment must be increased with a mandatory reporting requirement against sustainability targets. See Labor recommendation 3.
Recommendation 21	
The committee recommends that the Australian Government's various corporate responsibility programs be co-ordinated through a whole-of-government approach.	Disagree. Labor members believe that government's corporate responsibility related programmes should be developed and delivered through a Corporate Responsibility Unit in a single, business related government department. See Labor

	recommendation 1.
Recommendation 22	
The committee recommends that the Australian Government, in consultation with the investment community, develop educational material; • regarding materiality of non-financial risks, for use by institutional investors and fund managers and; • to promote the United Nations Principles for Responsible Investment to institutional investors and fund managers.	Agree in principle. Engagement with the investment community must extend to engagement on emerging sustainability risks and how to define and value those risks. See Labor Supplementary Report section – Better engage the investment sector.
Recommendation 23	
The committee recommends that the Australian Government, in consultation with relevant sections of the business community, undertake research into quantifying the benefits of corporate responsibility and sustainability reporting.	Agree in principle. Labor recommends that the National Sustainability Council should contribute to and auspice this research
Recommendation 24	
Although recommending that it is premature to adopt the Global Reporting Initiative Framework, the committee recommends that in addition to the continued monitoring of its uptake, the Australian Government provide guidance to the business community, including the small business community, on how to apply the Global Reporting Initiative Framework.	Agree.
Recommendation 25	
The committee recommends that the Australian Government develop educational material to promote the UN Global Compact and to encourage Australian companies to become signatories where it is appropriate for them.	Agree.
Recommendation 26	
To protect Australia's interests, the committee recommends that where appropriate, the Australian Government facilitate and	Agree.

coordinate the participation of Australian corporations in international corporate responsibility initiatives.	
Recommendation 27	
The committee recommends that the Australian Government in collaboration with relevant not-for-profit organisations, develop educational materials for not-for-profit organisations to promote the benefits of corporate responsibility within their own organisations.	Agree.
Recommendation 28	
The committee recommends that as a way of facilitating greater uptake of sustainability reporting, 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 that commence sustainability reporting for the first time.	Agree.
Recommendation 29	
The committee recommends that the Australian Government consider options for providing regulatory relief to corporations which voluntarily undertake specified corporate responsibility activities.	Agree. Labor recommends a full audit of regulatory incentives and disincentives to adoption of corporate responsibility measures. See Labor recommendation 7.

ADDITIONAL REMARKS BY SENATOR ANDREW MURRAY, AUSTRALIAN DEMOCRATS SENATOR FOR WESTERN AUSTRALIA

1.1 The Australian Democrats support the Report of the Parliamentary Joint Committee on Corporations and Financial Services: *Corporate responsibility: Managing risk and creating value.* The Report, including the Supplementary Report of the Labor members of the Committee, significantly advances parliamentary understanding of the Corporate Responsibility issues, and the recommendations of the Committee will assist considerably in Australian corporate entities 'lifting their game' in corporate responsibility reporting.

1.2 The Report recommendations, and the additional recommendations offered by Labor, deserve a serious and early response from the Government, the Australian Securities and Investments Commission, and the corporate and professional community.

1.3 During the hearings and in the submissions from the corporate sector, it appeared that many companies and directors were taking their corporate social responsibilities seriously and including them in their decision making.

1.4 I take the view that at the stage Corporate Responsibility reporting is in at present, it is not appropriate to introduce a mandatory code into Corporations Law in relation to corporate social responsibility.

1.5 Not every corporate is convinced of the value of the Corporate Responsibility concept. It was clear from many of the submissions and the hearings that a number of companies and directors were often motivated by the belief that they needed to address concerns of corporate social responsibility because of the impact on their reputation if they did not do so.

1.6 Many corporations and directors do not appear to embrace the concept itself, but by including these considerations in their decision making are attempting either to circumvent circumstances which might give rise to expensive litigation, or to avoid community agitation.

1.7 Such motives are not typical of leading companies and directors, who have recognised the significant and material contribution Corporate Responsibility reporting can make to the long-term health of the corporation.

1.8 However, the steps that have been taken so far by many large corporations need to be monitored. The obligations of corporate social responsibility also need to be monitored in relation to many medium and small companies whose actions and production methods can have an impact on their workers and the environment in ways similar to their larger counterparts.

1.9 The need for further progress has of necessity to focus on the laggards as well as the leaders. If there is no ongoing improvement across all sectors in the next three to five years, at least to the level of comparable advanced OECD countries, then in the view of the Democrats it will be essential to re-visit the need for a mandatory code. Therefore I agree with Recommendation 4 of Labor's Supplementary Report that

> ...if directors do not actively consider legitimate environmental and social risks in determining the interest of the company, it will be necessary for the Parliament to provide a clearer articulation of this interpretation within the Corporations Act.

1.10 I agree with Labor's Supplementary Report that:

> ...In order to increase the number of corporate, non-government and government organisations that deeply integrate sustainable and responsible activities over the medium term (5 – 10) years, government must play a more engaged and strategic role now.

1.11 I was particularly attracted to Labor's notion that mandating Corporate Responsibility reporting in the federal public sector, in large and relevant agencies, would usefully advance the cause. Such action in the public sector may need to follow, not precede, the identification of appropriate reporting and benchmarking frameworks. I am referring of course to Labor's Supplementary Report Recommendation 3 that states:

> ...The Australian Government make reporting against sustainability targets mandatory for Australian Government agencies. This reporting should include:
>
> - Performance against sustainability targets set by the National Sustainability Council regarding water, energy, waste, vehicles, general procurement and other applicable targets;
> - Progress achieved on meeting the targets if they are not met and strategies to ensure that targets are met in the future.

1.12 I also support Recommendation 10 of Labor's Supplementary Report regarding the UN Convention Against Corruption and the OECD Anti-Bribery Convention and look forward to the early introduction of amending legislation to address the concerns raised in the OECD Report about shortcomings in Australia's adoption in the Criminal Code, of aspects of its Anti-Bribery Convention.[1]

1 See also Senate Hansard 14 June 2006, Senator Andrew Murray – Matters of Public Interest – *Ethics and Integrity in Public Life*

Senator Andrew Murray

APPENDIX 1

SUBMISSIONS RECEIVED BY COMMITTEE

1	The Corporate Research Group
2	Dr Gianni Zappalà, University of Sydney
3	The Bouyancy Foundation of Victoria
4	Homeless Persons' Legal Clinic
5	Mr Richard Turner
6	Mr Robert C Hinkley
7	Mr Michael Kerr
8	Professor Brian Ellis
9	Brotherhood of St Laurence
10	Australian Council of Trade Unions
11	Professor Geoffrey George
12	Compact Consulting
13	BHP Billiton
14	Professor Bryan Horrigan
15	Coles Myer Ltd
16	Dr Shann Turnbull, International Institute of Self-Governance
16a	Dr Shann Turnbull, International Institute of Self-Governance
17	Xstrata Copper
18	Professor Boris Kabanoff
19	BT Governance Advisory Service
20	Australian Human Rights Centre
21	Australian Conservation Foundation
21a	Letter from Transurban
21b	Response from ACF to Transurban

21c	Letter from Transurban
22	Ms Therese Wilson
23	Philanthropy Australia
24	The Finance Sector Union of Australia
25	The Smith Family
26	Ms Eva Cox
27	Group of 100
28	Chartered Secretaries Australia
29	Insurance Australia Group
30	AMPCI Sustainable Funds
31	*See separate entry on corporate responsibility submission
32	Association of Chartered Certified Accountants
33	The Commercial Law Association of Australia
33a	The Commercial Law Association of Australia
34	Mr Ray Bicknall
35	Mr John August
36	Volunteering Australia
37	Melkonian & Company
38	Freehills
39	Dr Anthony Forsyth, Consulting Solicitors
40	Mission Australia
41	Positive Outcomes
42	The Body Shop
43	Greenpeace
44	Social Response Index
45	Oxfam Australia
46	Ms Lucinda Wilson

47	National Farmers' Federation
48	Australian Network of Environmental Defender's Offices
49	GlaxoSmithKline
50	St James Ethics Centre
51	ECOS Corporation
52	Commonwealth Scientific and Industrial Research Organisation
53	KPMG
54	Human Rights Council of Australia
55	Mrs Janice Tendys
56	Total Environment Centre and Green Capital program
57	Mannkal Economic Education Foundation
57a	Mannkal Economic Education Foundation
58	Australian Securities & investment Commission
59	Australian Institute of Social & Ethical Accountability
60	Hon Doug Everingham
61	Centre for Volunteering
62	Mr James Hazelton, Macquarie University
63	Australian Centre for Corporate Social Responsibility
64	Law Student Community Support
65	NSW Young Lawyers
66	Public Interest Law Clearing House
67	Mr Tom Bostock
68	Unilever Australasia
69	Ms Elizabeth Klein and Professor Jean J du Plessis
70	Australian Council of Social Service
71	Hon Dr Ken Coghill, Dr Leeora Black, Mr Dough Holmes (Monash University)
72	National Institute of Accountants

73	Australian Institute of Company Directors
74	The Shell Company of Australia
75	Employment Studies Centre
76	Public Interest Advocacy Centre
77	Credit Union Services Corporation (Australia)
78	ALCOA World Alumina Australia
79	Gippsland Community Legal Service
80	Key Centre for Ethics, Law, Justice & Governance, Griffith University
81	Telstra Corporation
82	Beerworth & Partners
83	National Pro Bono Resource Centre
84	Professor Paul Redmond
84a	Professor Paul Redmond
85	Boral Limited
86	RepuTex Ratings & Research Services
87	Mr Ben Neville
88	Dr Robert Gale
89	Consumers' Federation of Australia
90	Amnesty International
90a	Amnesty International
91	Mr Ian McGregor, University of Technology
92	Chamber of Commerce and Industry of Western Australia
93	Corporate responsibility
94	Westpac Banking Corporation
94a	Westpac Banking Corporation
95	Mr Larry Noye
96	Professor Craig Deegan, RMIT University

97	Australasian Investor Relations Association
98	Mr Nick Pastalatzis
99	Mallesons Stephen Jaques
100	The Institute of Chartered Accountants in Australia
101	Australia and New Zealand Banking Group
102	Novartis Pharmaceuticals Australia
103	CPA Australia
103a	CPA Australia
104	Dr Sean Cooney
105	Ethical Investment Association
106	Australian Bankers' Association
106a	Australian Bankers' Association
107	Australian Consumers' Association
108	Business Council of Australia
108a	Business Council of Australia
109	Australian Business and Community Network
110	Price Waterhouse Coopers
111	BP Australia
112	British American Tobacco Australia
113	Professor Thomas Clarke, University of Technology
114	General Motors Holden
115	National Australian Bank
115a	National Australian Bank
116	Department of the Environment and Heritage
117	Ms Julianna O'Bryan
117a	Ms Julianna O'Bryan
118	Mr David White

119	Futureye
120	Newmont Australia
121	Origin Energy
122	Mr Lakun Agrawal
123	Tasmanian Farmers and Graziers' Fair Dinkum Food Campaign
124	Australian Stock Exchange
125	Habitat for Humanity Australia
126	Hon Dr Gary Johns
127	United Nations Environment Programme Finance Initiative Australasian Operational Environmental Management and Reporting Advisory Committee
128	Professor Margaret Nowak
129	Professor Peter Newman
130	Global Reporting Initiative
131	Mitsubishi Motors Australia
132	Ms Yolanda Morris, Centrelink Rural Call SA
133	Department of Families, Community Services & Indigenous Affairs
134	Department of the Treasury
135	Centre for Corporate Public Affairs
136	Centre for Public Agency Sustainability Reporting
137	Sustainable Asset Management
138	Santos
139	Mr Alistair Ping
140	Dr David Wishart
141	Graduate School of Business, RMIT
142	Fuji Xerox
145	St James Ethics Centre & Caux Round Table
143	QBE Insurance Group
144	Law Council of Australia

Many submitters sent in a standard letter concerning corporate responsibility. These submissions were each accepted but listed only once, as Submission 31. The following submitters provided these letters:

James Clark
Nick Ray
Kerry Lymn
Alex Muir
Luis Josa
Anne Marie Knight
Stephanie
Jaden Harris
Alexander Cox
Wajan Hale
Mathew Werigi
Anna Migdal
Louise Cross
Gwyneth Walters
Leanne Beazley
Ian Smallman
Brett Naseby
Will Olsson
Zeb Davy
James O'Brien
Wayne Martin
Adele Dodds
Julie Ryan
Christina Tassell
Anna Kay
Vandra Stenton
Leanna Ruditsch
Andrea Borbas
Justin George
Stuart Porteous
Kerri Howlett
Angela Ballard
Damon Roberts
Sandra Bonney
Therese Howard
Amelia Flanagan
Anna Mitchell
Sarah Roberts
Alex Budlevskis
Kirsty Tait
Julia Sideris
Zoe Amelia Riddle
Noelle Rattray
Linda Edwards
Wendy Gooding

John Finch
Vicki-Lee Pride
Garry Jones
Lucia Fischer
Graham Hubbard
Leah Furness
Ami Rakus
Michele Smith
Jenni Sanders
Mrs Chris Ennis
Charlse Newman
Hope Foley

APPENDIX 2

PUBLIC HEARINGS AND WITNESSES

<u>WEDNESDAY 23 NOVEMBER 2005 – SYDNEY</u>

The Commercial Law Association of Australia

ARMSTRONG, Mr Daren, Secretary, Legislative Review Task Force

DREISE, Mr Anthony, Director, Legislative Review Task Force

DURIE, Mrs Anne, Member, Legislative Review Task Force

FINNANE, Mr Edmund, Member, Legislative Review Task Force

St James Ethics Centre

LONGSTAFF, Dr Simon, Executive Director

Ethical Investment Association

O'HALLORAN, Ms Louise, Executive Director

Chartered Secretaries Australia

SHEEHY, Mr Tim, Chief Executive

FOX, Ms Judith, Director, Policy

The Smith Family

SIMONS, Dr Robert, National Manager, Strategic Research and Social Policy

Australian Council of Social Service

O'DONOGHUE, Mr Philip, Deputy Director

KIRKLAND, Mr Alan, Treasurer

Australian Institute of Company Directors

EVANS, Mr Ralph, Chief Executive Officer

BAXT, Professor Bob, AO, Chairman, Law Committee

BERG, Mr Tony, AM, Member, Corporate Governance Committee

COLEMAN, Mr Michael, Chairman, Reporting Committee

FARRELL, Ms Kathleen, Member, Law Committee

Westpac

PURCELL, Dr Noel, Group General Manager

WILLIAMS, Mr Timothy, Senior Adviser, Corporate Responsibility and Sustainability

International Institute for Self-Governance

TURNBULL, Dr Shann, Principal

University of Sydney

ZAPPALA, Dr Gianni, Director, Orfeus Research and Adjunct Professor Economics and Politics

MONDAY, 20 FEBRUARY 2006 - PERTH

Murdoch University

NEWMAN, Professor Peter W.G., Director, Institute of Sustainability and Technology Policy, Murdoch University; Chair, Sustainability Roundtable, Western Australian Government

STANTON-HICKS, Mr Erik, Researcher and PhD Candidate, Institute for Sustainability and Technology Policy

Alcoa World Alumina Australia

GOH, Mr Gavin, Adviser, Corporate Affairs

HORNE, Mr Kim, Refinery Manager, Pinjarra

RUSSELL-BROWN, Ms Anne, Manager, National Community Partnerships and Sponsorship

Corporate Governance and Social Responsibility Research Unit, Curtin Business School, Curtin University of Technology

McCABE, Dr Margaret, Director, Corporate Programs

NOWAK, Professor Margaret, Research Director

RATH, Dr Subhrendu, Associate Professor, School of Economics and Finance

Wesfarmers

KESSELL, Mr Keith, Executive General Manager, Corporate Affairs

Chamber of Minerals and Energy, Western Australia

COHEN, Ms Allison, Executive Officer, Indigenous Affairs and Land Access

Rio Tinto

SERMON, Ms Robyn, Manager

<u>THURSDAY, 23 FEBRUARY 2006 - MELBOURNE</u>

The Body Shop

McDONALD, Mr Alex, Senior Corporate Adviser

VAN DER LEEST, Ms Amanda, Organisational Development Adviser

WALLACE, Ms Louisa, General Manager, People and Performance

RepuTex Australia Pacific Pty Ltd

COHN, Mr Philip, Associate Director, Research

LEE, Mr Graeme, Chairman

MORAN, Mr Michael, Research Analyst

Australian Council of Trade Unions

APPLE, Mr Nixon, Industry Investment and Policy Adviser

BOWTELL, Ms Catherine, Industrial Officer

ESLAVA, Mr Luis, Corporate Social Responsibility Adviser

TATE, Ms Alison, International Officer

Finance Sector Union

BENNETT, Mr James, Policy and Research Officer

MASSON, Mr Rod, Manager, Policy and Communications

Consumers' Federation of Australia

WOLTHUIZEN, Ms Catherine Nicloe, Chair, Consumers Federation of Australia

BHP Billiton

FAST, Mr John, Chief Legal Counsel and Head of External Affairs

GlaxoSmithKline

GOSMAN, Mr Alex, Director, Government and Corporate Affairs

Shell Australia Ltd

SIMPSON, Mr John, Director, External Affairs

Philanthropy Australia

ANDERSON, Ms Gina, Chief Executive Officer

CPA Australia

PURCELL, Mr John, Policy Adviser

COUGHLIN, Mr Mark, National President

Business Council of Australia

MUNCHENBERG, Mr Steven, Deputy Chief Executive

EDWARDS, Ms Leanne, Senior Analyst

FRIDAY, 24 FEBRUARY 2006 – MELBOURNE

Group of 100

HARRIS, Mr Geoffrey, National Executive Coordinator

HONAN, Mr Thomas, National President

Brotherhood of St Laurence

McHUTCHISON, Mr Ian, General Manager, Social Enterprises

LILLYWHITE, Ms Serena, Manager, Ethical Business

Oxfam Australia

ENSOR, Mr James, Director, Public Policy and Outreach

MARTIN, Ms Shanta, Advocacy Coordinator, Extractive Industries

KPMG

BRAY, Mr Michael, Partner

MULCARE, Mrs Catherine, Director, Audit and Risk Advisory Services

Fair Dinkum Food Campaign

BOVILL, Mr Richard, Organiser

Monash University

ANDERSON, Dr Helen, Acting Head of Department, Department of Business Law and Taxation

GUMLEY, Mr Wayne Stephen, Senior Lecturer, Department of Business Law and Taxation

Victoria University

GEORGE, Professor Geoffrey, Victoria Graduate School of Business and the School of Accounting and Finance

Australian Conservation Foundation

BERGER, Mr Charles, Legal Adviser

Public Interest Law Clearing House

LOVETT, Ms Tabitha, Manager

URE, Mr Sam, Solicitor

Homeless Persons Legal Clinic

HILTON, Miss Kristen, Coordinator and Principal Solicitor

LYNCH, Mr Philip, Director, Human Rights Law Resource Centre

Australian Centre for Corporate Social Responsibility

BLACK, Dr Leeora, Managing Director

HOHNEN, Mr Paul, Founder and Chief Executive, Sustainability Strategies

<u>THURSDAY, 9 MARCH 2006, SYDNEY</u>

Insurance Australia Group

MOSTYN, Ms Sam, Group Executive, Culture and Reputation

GREGG, Ms Pauline, Senior Manager, Corporate Social Responsibility

Unilever Australasia

GODDARD, Mr Nicholas, Corporate Relations and Communications Director

CLARRY, Ms Sarah, Corporate Social Responsibility and Communications Manager

Habitat for Humanity Australia

McLELLAN, Mr Anthony, Chairman

Private Capacity

REDMOND, Professor Paul

Australian Bankers Association

BELL, Mr David, Chief Executive Officer

TATE, Ms Diane, Director, Corporate and Consumer Policy

Ecos Corporation

HOGARTH, Mr Murray, Senior Associate

WHITNALL, Ms Jennifer, Senior Consultant

PricewaterhouseCoopers

RIDEHALGH, Mr David, Partner and Head, Corporate Communications Team

Total Environment Centre

MOHR, Mr Tony, Associate Director

Greenpeace

COLLINS, Mr Jason, Corporate Campaigner

Public Interest Advocacy Centre

BAILEY, Ms Jemma, Trade Justice Policy Officer

RANALD, Dr Patricia, Principal Policy Officer

Environmental Defender's Office

SMITH, Mr Jeffrey, Chief Executive Officer

New South Wales Young Lawyers

LAIRD, Mr Nathan, Member

MATHEWS, Ms Lily, Member

Private Capacity

JOHNS, The Hon Dr Gary

FRIDAY, 10 MARCH - SYDNEY

Australian Stock Exchange

MAYNE, Mr Eric, Group Executive, Market Supervision, Australian Stock Exchange; and Chair

Beerworth and Partners

BEERWORTH, Mr William, Managing Director

Corporate ResponseAbility

FUNNELL-MILNER, Ms Linda, Director

Global Reporting Initiative

HENDERSON, Dr Judy, Chairperson

University of Technology Sydney

COX AO, Ms Eva, Senior Lecturer and Program Director, Faculty of Humanities and Social Sciences

Australian Human Rights Centre

NOLAN, Ms Justine, Associate

Amnesty International Australia

SMITH, Ms Rebecca, Advocacy Coordinator

MacMAHON, Mr Rohan, Business Group Member

BT Governance Advisory Service

MATHER, Mr Erik, Head

Compact Consulting

SIDOTI, Mr Eric, Consultant

VAN BEEK, Mr Harris, Consultant

Association of Chartered Certified Accountants

DEEGAN, Professor Craig, Judge, ACCA Sustainability Reporting Awards

FRANCIS, Mr Richard, Head, Australia and New Zealand

MONDAY, 27 MARCH 2006 - CANBERRA

Australasian Investor Relations Association

MATHESON, Mr Ian, Chief Executive Officer

Telstra

GRATION, Mr Douglas, Company Secretary

Mallesons Stephen Jaques

BEDNALL, Mr Timothy, Partner

Department of the Environment and Heritage

McGLYNN, Mr Gene, Assistant Secretary

STARR, Dr Paul, Senior Policy Officer

WEDNESDAY, 29 MARCH – CANBERRA

Xstrata

SARA, Ms Susan, Manager, Corporate Affairs

Australian Securities and Investments Commission

COOPER, Mr Jeremy, Deputy Chairman

Department of the Treasury

BRINE, Mr Matthew, Manager, Governance and Insolvency Unit

HACKETT, Mr Greg, Policy Analyst, Governance and Insolvency Unit

MURPHY, Mr Jim, Executive Director, Markets Group

MILLER, Mr Geoffrey, General Manager, Corporations and Financial Services Division

Department of Families, Community Services and Indigenous Affairs

HUNTER, Mr Stephen, Deputy Secretary

McKENZIE, Ms Cate, Group Manager, Communities

<u>WEDNESDAY, 5 APRIL 2006 – MELBOURNE</u>

National Australia Bank

CLYNE, Mr Cameron, Executive General Manager, Group Development

BISSETT, Ms Rosemary, Group Manager, Corporate Social Responsibility

Sustainable Asset Management (SAM) Research

GREY, Mr Francis, Research Manager and Founding Principal (Australia),

General Motors Holden

SHEEHAN, Ms Catherine, National Manager, Corporate Responsibility

Australia and New Zealand Banking Group Ltd

BISINELLA, Ms Julie, Head of Corporate Responsibility

NASH, Ms Jane, Head of Government and Regulatory Affairs

BROWN, Mr Gerard, General Manager, Corporate Affairs

Origin Energy Ltd

HUNDY, Mr William, Company Secretary

WOOD, Mr Tony, General Manager, Public and Government Affairs

Santos Ltd

EAMES, Mr Martyn, Vice President, Corporate and People

Australian Council of Super Investors

McCLUSKEY, Ms Amanda, Manager, Sustainability, Portfolio Partners Ltd; and Adviser, Corporate Social Responsibility

SPATHIS, Mr Phillip, Executive Officer

Centre for Public Agency Sustainability Reporting

IVERS, Mrs Joanna, Assistant Director

LEESON, Dr Robyn, Director

National Institute of Accountants

AGLAND, Mr Reece, Technical Counsel

RAVLIC, Mr Tom, Policy Adviser, Financial Reporting and Governance