



16 September 2005

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
Parliament House
Canberra ACT 2600
Australia

Email: corporations.joint@aph.gov.au

Dear Sir/Madam,

**Submission to Parliamentary Joint Committee
Inquiry into Corporate Responsibility**

The Institute of Chartered Accountants in Australia ('The Institute') appreciate the opportunity to make a submission to the Commonwealth Parliamentary Joint Committee's Inquiry into Corporate Social Responsibility. Whilst the Institute acknowledge that in the wake of some public corporate irresponsibility, legislative changes may seem necessary, they are of the opinion that the necessary changes are more likely to be achieved through robust utilisation of current laws and changes to corporate cultures than legislative amendment.

This response to Committee's Inquiry has been prepared by our Legislation Review Board ('LRB'). The LRB is administered by the Australian Accounting Research Foundation. The LRB is appointed to advise on matters of legislative and regulatory policy affecting financial reporting, auditing and corporate governance.

Should you wish to discuss the Institute's submission further, please contact Jan Macpherson, Secretary to the Legislation Review Board on (03) 9885 4748 or by email at legislationreviewboard@yahoo.com.au.

Yours sincerely

Stuart A Black FCA
PRESIDENT
c.c. J Macpherson - LRB

Corporate Responsibility and Triple-Bottom-Line Reporting

Submission by the Institute of Chartered Accountants in Australia

The Parliamentary Joint Committee on Corporations and Financial Services' enquiry into Corporate Responsibility and Triple-Bottom-Line reporting, for both for profit and not-for-profit incorporated entities under the Corporations Act in Australia, has asked those filing submissions to have 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 of 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.

To what extent do organisational decision-makers have an existing regard for the interests of stakeholders other than shareholders, and the broader community?

Triple Bottom Line reporting has developed out of a realisation by Australian businesses that businesses need to be sustainable in order to survive and prosper in the long term. The Institute suggest that the Business Council of Australia's statement recognizing that 'Business has an important role to play in [the sustainable development] process, particularly through its management of the financial, environmental and social dimensions of corporate activities, products and services'¹, is a clear indication of the wider considerations that underlie corporate governance today.

The *James Hardie* experience has precipitated a review of the interests of stakeholders and the community because of the high level of publicity, but the Institute suggest that it is clear from the reaction, albeit a reaction that was a long time coming, of the James

¹ Business Council of Australia, foreword to Group of 100's 'Sustainability: a Guide to Triple Bottom Line Reporting'

Hardie Board that they are now taking into account the effect on the company's reputation through the community activism resulting from their actions.

Directors have responsibility to the company and in the normal course of events would address 'stakeholder' issues to ensure the company survives and prospers. This recognises that a company is an enterprise that seeks to create value², only partly through production of financial profits. The creation of value results from the exercise of sound business judgement in a wider framework that required by regulation. In fact, Young³ suggests that regulating directors of public companies to balance the claims of multiple stakeholders would '... crowd out judgement and discretion, which is what boards are there to provide.'

To what extent should organisational decision-makers have regard for the interests of stakeholders other than shareholders, and the broader community?

The Institute are of the view that corporations recognise that sustainable business operations and thus sustainable financial performance are dependant on building and maintaining the trust and respect of the community, and in the vast majority of cases, act accordingly. There is a growing realisation that a short term profit focus may be inconsistent with a company's long term viability – however this is culture based rather than regulation based.

Regard should be given to the interests of shareholders, stakeholders and the general community to the extent that taking these interests into account add value to the business operations and evidence the corporation's 'license to operate'. In this framework it is recognised that it is likely to be those that are 'key' stakeholders rather than all and sundry to whom regard is given. In this context key stakeholders include employees, various tiers of government, suppliers and customers. Despite director's best endeavours, it is acknowledged that some people or groups will nevertheless be aggrieved by corporate actions.

To what extent does the current legal framework governing directors' duties encourage or discourage them from having regard for the interests of stakeholders other than shareholders, and the broader community?

There is some argument whether the current responsibility on directors to act in the best interests of their company, limit that to financial reward for shareholders or whether their responsibility extends further to consideration of the interests of stakeholders.

² 'Corporate Social Responsibility', Harrison Young, 18 August 2005

³ supra

The Institute take a broader view of director's responsibilities, and support the interpretation that directors' duties can readily include consideration of stakeholder and community issues as a means of enhancing corporate reputation and consequently the longer term value of the shareholders' interest. In fact, the requirement for directors in their report, to comment on compliance with environmental regulations affecting the corporation, evidences the benefits in looking beyond financial performance for corporate success.

The Institute are of the view that it is not the legal framework that provides encouragement or discouragement from having regard for the interests of stakeholders other than shareholders, and the broader community, but rather the culture of the company. Whilst some aspects of the legal framework, such as the ASX Good Corporate Governance Best Practice Recommendations, do provide a reference point it is more the realization that a culture of enhancement of reputation will benefit the corporation that provides encouragement and contribute to its survival and growth in the longer term.

Are revisions to the legal framework, particularly to the Corporations Act, required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders other than shareholders, and the broader community? What obligations that exist in laws other than the Corporations Act should also be considered?

No, the Institute do not consider amendments to the *Corporations Act* are necessary to enable or mandate that directors take into account the interests of stakeholders other than shareholders and/or the broader community. In fact, to do so seems to assume that directors do not already take such interests into account which is probably not the case in the majority of companies.

Ralph Evans⁴ believes that any alterations to the fundamental concepts of Australian corporate law should be approached with great caution as such reforms could have significant adverse consequences for thousands of companies and should not be introduced merely in response to the unique situation of James Hardie. This reflects the view of the Institute who encourage more robust application of the *Corporations Act* rather than changes to the legislation.

The ASX Principles of Good Corporate Governance and Best Practice Recommendations in Principle 10 recommends that companies recognise the legitimate interests of stakeholders and recognise legal and other obligations to legitimate stakeholders. The effect of Recommendation 6.1, although directed primarily at shareholders, has the effect of wide dissemination of information to the wider community, which in turn enables the community's involvement in the corporation. Whilst these Principles do not apply to non-listed incorporated entities, they nevertheless provide a sound and often utilised basis for

⁴ CEO of the Australian Institute of Company Directors, as reported in 'Keeping Good Companies', July 2005

non-listed for profit and not-for-profit corporations. Many corporations, particularly non-for-profit organisations, already have regard to community and stakeholder interests as an integral part of the organisation's objects or constitution and it could be counter-productive to legislatively mandate something that is already being done on a 'voluntary' basis. In addition reporting in this area is developing and mandating such reporting may inhibit experimentation with different forms of reporting.

Amending legislation to impose obligations to take stakeholder and community interests into account seems to assume '...that taking into account stakeholder interests is in some way contrary to the best interests of the corporation'.⁵ The Institute is of the view that this is simply not the case. In their opinion both short term shareholder and financial (profit) objectives are combined with the 'bigger picture' stakeholder and community considerations for the greater long terms benefit of the company and all those who are in any way affected by its operations.

Are there any alternative mechanisms, including voluntary measures that may enhance consideration of stakeholder interests by incorporated entities and/or their directors?

The Institute is aware of some successful awards, such as the Banksia awards and the reporting awards that seem to enhance consideration of stakeholder interests by corporations. The communication of these awards within the participating corporations are part of the growing company culture of considerations other than the short term financial rewards. The growing respect accorded to awards of this type can also be a means of enhancing consideration of stakeholder interests by corporations.

Another mechanism recognised as successful by the Institute is the move away from rewarding short term KPI's to rewarding a mixture of short, medium and long term KPI's for senior executives. This has the tendency to move the focus of key management from short term profits to overall business sustainability for the long term thus subtly changing the short term profit culture existing in some corporations.

Are reporting requirements associated with these issues appropriate?

Most voluntary measures taken by a corporation to enhance consideration of stakeholder interests do not have reporting requirements. The Institute believe that any shift towards mandating prescriptive disclosures would be highly premature and may in fact inhibit disclosure.

There is however, a requirement to report the top five remunerated executives. Although reporting of bonuses is part of a company's remuneration report, reporting of director and executive remuneration does not differentiate between bonuses for short or long term achievements. Where bonuses are awarded for different components of achievement it may be appropriate to report on the breakup of the remuneration.

⁵ McConvill J. Australian Financial Review, July 2005, "Law already looks kindly on directors who care"

The reintroduction⁶ of Value Added Statements⁷ (VAS) may also provide some real benefits with regard to corporate accountability, as VAS' provide shareholders and the community with an idea of the real value created by the corporation rather than just the profit generated.

Could regulatory, legislative or other policy approaches in other countries be adopted or adapted for Australia?

The Institute is aware that several US states have legislation that authorizes directors to consider the interests of stakeholders other than shareholders. However, it is not considered necessary that such changes be made as we are of the view that such considerations already fall within directors' duties as defined in the *Corporations Act*. We reiterate that we consider 'director's duties' readily include consideration of stakeholder and community issues as a means of enhancing corporate reputation and consequently the longer term value of the shareholders' interest.

⁶ In common use in the 70's and 80's – Dr Chris van Staden, Massey University School of Accounting

⁷ A financial statement disclosing for a period how much value has been added by the operation of an enterprise and how that value has been distributed among employees, government, providers of capital and for reinvestment in the business. Gross value added is equal to sales less bought-in goods and services; net value added is equal to gross value added less depreciation. <http://www.indiainfoline.com/bisc/accv.html>