The Secretary
Parliamentary Joint Committee on Corporations
and Financial Services
Suite SG.64
Parliament House
CANBERRA ACT 2000

15 September 2005

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Dear Sir

Inquiry into Corporate Responsibility

In response to the request for written submissions, I am pleased to provide you with the views of the Association of Chartered Certified Accountants (ACCA).

ACCA is the largest and fastest growing international accountancy body with over 345,000 members and students operating in 170 countries around the world. ACCA is widely seen as leading the global accountancy profession in the area of sustainable development and corporate responsibility. ACCA organises sustainability reporting award schemes in four continents (including Australia/New Zealand) and, in the UK, has been awarded the prestigious Queen's Award for Enterprise: Sustainable Development in recognition of our leadership activities. ACCA is represented on the Board and Technical Advisory Committee of the Global Reporting Initiative (GRI).

As befitting our global spread, this response seeks to provide an international perspective on the issues raised by the Inquiry, but at the same time it has benefited greatly from the views of the judges of the ACCA Australia/New Zealand Sustainability Reporting Award scheme, all of whom are closely connected with the corporate responsibility environment.

We would be happy to provide additional information on any of the matters covered by this response.

Yours faithfully

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Inquiry into Corporate Responsibility

Comments from the Association of Chartered Certified Accountants (ACCA)

We note that the Committee will 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, 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.

Our response deals collectively with issues A – D above and then addresses issues E, F and G in turn.

Responsibilities of directors and corporations

A].	**the extent to which organisational decision-makers have an existing regard for the interests of stakeholders, 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**

Who are companies run for? – the UK experience

One of the core issues considered by the UK company law review (CLR) project between 1998 and 2001 was the scope of company law, and in particular the issue of which parties companies should be run in the interests of. The company law review steering group distilled this discussion into two possible future options

i) the 'pluralist' approach, and
ii) the enlightened shareholder value approach. [1]

Under option i) directors would be legally required to run their company with a view to serving the interests of a wide group of stakeholders and/or interests. This wider group of stakeholders or interests could either be defined in law or left fairly open. Either way,

[1] The arguments for and against these two options were discussed principally in chapter 5.1 of the consultation paper 'The Strategic Framework'. This can be found on the attached link.

http://www.dti.gov.uk/cld/comlawfw/framewrk.pdf the extended group of stakeholders would have a legal right of redress if they considered that the directors were failing to serve their particular sectional interests.

Under option ii) directors would still be primarily answerable to the company's members. But the law would recognise that companies exist within wider society and that the way that companies deal with elements of wider society should be regarded as being a contributory factor in assessments of their performance. Accordingly, under this option, an extended range of stakeholder concerns would need to incorporated into the scope of directors' legal responsibilities and disclosure rules would need to be amended so as to require companies to report on how they have addressed this extended range of concerns.

In ACCA's view there are two basic realities which underlie the existence of all limited companies, whether they be private or public and whether they are limited by guarantee or by shares.

Firstly, any company is set up by its incorporators in order to carry out particular activities or to achieve certain objectives. It is the company's incorporators (and their successors) who define the company's operational character and who provide its core financial commitment. Without the initiative of the incorporators, any company would not have come into being in the first place.

Secondly, via the process of incorporation, the entity will have acquired material legal privileges, most notably regarding perpetual existence and limited liability for its members. These privileges mean that the law will offer a protection to those acting within the company format that would not be available in respect of individuals conducting business alone or who do so within non-corporate business formats.

In our view, it is these two realities which should be paramount in discussion of the proper extent of companies' responsibilities to 'stakeholders'. In the former case, it is the company's incorporators (and successor members) who are directly interested in the company's affairs, in terms of deciding on its range of activities, on collectively bearing its financial risk and on sharing in its profits. It therefore follows that those who manage the company's affairs should owe responsibilities to its members to act in their best interests. In the latter case, the law agrees to extend legal recognition and protection to businesses that choose to incorporate even though the interests of individual business people or members of the public are put at risk at a result.

It is, we suggest, the natural corollary of the legal act of incorporation that the state is entitled to expect that a company should owe certain responsibilities to act in what the state defines as the "general public interest".

We agree that, in respect of both cases, there is scope for the revision and extension of current obligations. As far as duties to members are concerned, there must be a more sensible balance than exists at present between, on the one hand, rules designed to ensure legitimate member involvement in company affairs and, on the other, freedom for companies to concentrate on actually running their business without unnecessary distractions.

As far as responsibilities to the law are concerned, the notion of the 'public interest', on which all reporting obligations are, arguably, based, has to be seen as an evolving concept. If society itself is changing, and if particular issues come to be viewed as having wide social significance, then it is reasonable for the law's definition of the public interest in the context of limited companies to also change. Limited companies have a huge impact not only on the economic and commercial life of the country but on society at large.

We believe, therefore, that it is, in principle, legitimate for the law - as it is applied to limited companies - to incorporate specific measures designed to reflect and promote the wider public interest. We consider, however, that it is a dramatic and ill-advised step to go from this to suggest that directors of limited companies be required to adopt a fully pluralist approach to corporate governance.

Our view is that directors should retain the discretion to decide what constitutes the best interests of their company, within the framework set down by the law to govern the nature of fiduciary duties and the duties of skill and care. While there may be scope for non-statutory action to encourage directors to widen the range of factors that they take into account, we see this as a matter for best practice guidance, or education, and we do not consider that it should be the function of the Corporations Act to oblige directors explicitly to take into account an extended range of interests.

ACCA does not believe that it is necessary to change radically the existing framework of responsibilities as between companies and their stakeholders. To move to the full pluralistic approach would risk suffocating the corporate decision-making process. The alternative approach - the so-called enlightened shareholder value (ESV) approach - is more realistic. This being said, statute law has an important role to play in terms of setting benchmarks for the stakeholder responsibilities that companies should be expected to assume. The accounts disclosure framework of the UK Companies Act and the Australian Corporations Act has been used increasingly in recent years to require companies to publish information on the extent to which they are conforming with various public policy ideals. We believe that this trend should be continued with new emphasis given to innovative forms of corporate reporting.

ACCA has been instrumental in developing new, voluntary forms of corporate reporting. Initially, our efforts were concentrated on the environmental field but more recently, we have expanded our activities to embrace sustainability (triple bottom line) reporting. We believe that, given the increasing interest in environmental and social impact issues, there is now sufficient evidence that it would be in the public interest for corporate law to require limited disclosure of the way companies impact on and interact with their stakeholders.

If it is accepted that it is in the public interest for limited companies to assume reporting obligations in respect of their impact on the environment, then, given wider share ownership, enhanced consumer awareness and a recognition on the part of many businesses that they should be prepared to present themselves to their markets as socially responsible organisations, there is a similar case for adapting company disclosure rules to cover other areas which have the potential to influence corporate reputations.

Among the individual areas that might be covered in new reporting rules are equal opportunity records, health and safety performance, policies regarding child labour, fraud and corruption policies, dealings with oppressive regimes, genetically modified foods, animal testing of consumer products.

In putting forward these thoughts on 'non-traditional' reporting, we are conscious of the concern among companies that they are burdened by an ever-increasing amount of compulsory disclosure. The scale of any new reporting responsibilities needs to reflect this reasonable concern.'

The UK outcome

The UK Government has endorsed the recommendation made by the Company Law Review team that UK law should move towards a new 'enlightened shareholder value' approach. It has published a draft Bill, which should hopefully become law in 2006, which will set out for the first time a "code of directors' legal responsibilities". This code will, inter alia, require company directors to take account of a number of new factors in the course of acting in the best interests of their companies. These specific factors are as follows;

- the likely consequences of their decisions in the long term and short term
- the need of the company to have regard to the interests of its employees
- the need of the company to foster its business relationships with its suppliers, customers and others
- the need to consider the impact of its operations on the community and the environment
- the need to maintain a reputation for high standards of business conduct.

So in deciding whether a company director is acting properly, a court will take into account whether he/she has paid due regard to the above specific factors.

Though not yet finally resolved, it is likely that shareholders in UK companies will be given the legal right to take action against their company's directors if they think they are in breach of their legal duties, including the duty of skill and care.

The UK Operating & Financial Review

Separately from these 'scope' changes, but directly related to them, the UK has already changed the law to require listed companies to prepare and publish a new statutory document, the Operating and Financial Review (OFR). In North America the OFR is generally know as the Management Discussion and Analysis (MD&A).

The new UK regulation requires reporting companies to report on the underlying factors which have contributed to the company's actual reported performance in the year under review, and to discuss the trends and factors which are likely to influence the company's future performance. In reporting in these terms, companies are required to comment on social/environmental/employee stakeholder factors to the extent that they are considered to be relevant to a proper understanding of the company's performance. Thus the OFR now plays the role of a reporting mechanism which acts to support the changes being made to the rules on directors' responsibilities.

The wording of the new legislation requires directors to report on employee, social and environmental issues to "the extent necessary" to comply with the general requirements of the OFR: that is, to enable shareholders to assess corporate strategies and the potential for such strategies to succeed.

International disclosure developments

We note that the International Accounting Standards Board (IASB) intends to issue a discussion paper called "Management Commentary" (MC). The IASB paper draws directly from relevant experience in the UK, Canada, the US and Germany. It seems likely that within 5 years, narrative reporting of significant financial implications of employee, social and environmental issues through a "Management Commentary" type addendum to the annual report and accounts will be commonplace for all listed companies around the world.

However, whilst it may be possible to encourage a limited range of employee, social and environmental disclosures by means of an OFR/MD&A/MC type instrument, it remains the case that the principal target of such disclosures is the, generally fiduciary, interests of the membership of the company and not the wider concerns of the wider stakeholder group.

With the exception of France, where blunt legislation requires a range of employee, social and environmental issues, there are few, if any, fully articulated disclosure regimes which seek to embrace stakeholder issues from a financial reporting perspective. For the most part, stakeholder accountability and disclosure occurs in the domain of voluntary environmental, social or sustainability (triple bottom line) reporting.

Conclusion on issues A - D

Statute law generally focuses on the information and governance needs of investors. To a very limited extent it also requires disclosure of some social/environmental issues (e.g. policies on disabilities, significant environmental liabilities, etc.).

Changes being made to UK company law and UK financial reporting standards are introducing a wider consideration of stakeholder issues than has hitherto been the case, but *without* fundamentally changing the nature of managerial responsibilities. Similar changes seem likely at the international level also – at least with respect to narrative reporting.

In order to avoid highly prescriptive disclosure requirements – which would doubtless incur the wrath of all report preparers and their lobbying representatives – it seems that most regulators and accounting standard setters are settling for an enhanced version of the status quo.

Alternative approaches to greater stakeholder engagement and transparency

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

Potential alternatives to changing the nature of directors' responsibilities include

- the introduction of mandatory narrative reporting
- greater governmental support for voluntary stand alone reporting
- encouraging greater corporate engagement with stakeholders
- encouraging a shift from short-termism to long-termism

Narrative reporting

We have discussed above recent innovations in narrative reporting known variously as the Management Discussion & Analysis (MD&A), Operating & Financial Review (OFR) or Management Commentary (MC).

Compliance with such instruments will require reporting entities to review the information needs and sustainability concerns of their wider stakeholder group. But in our view it is unwise to expect such reporting to deliver a full range of triple bottom line data. Most companies will choose to disclose a limited set of information relating to social, employee or environmental issues and the key criteria for determining that these disclosures will be relevance to the financial investment community. Thus we would certainly expect to see increased disclosures of the policies or risks associated with issues such as:

- carbon emissions
- emissions trading
- significant forthcoming environmental legislation
- human rights
- supply chain management
- bribery and corruption

and

- gender and disability issues

but not, unless deemed strategically important for sectoral reasons, disclosures regarding

- waste generated
- water use
- community investment
- biodiversity
- educations and training
- etc.

Stand alone sustainability reporting

We expect narrative reporting through the annual report and accounts to become commonplace for most listed companies in the next few years.

Stand alone triple bottom line reporting will, however, unless governments collectively undergo a radical shift in their attitude towards corporate regulation, remain a primarily voluntary activity.

KPMGs 2005 survey of sustainability reporting[2] shows that although sustainability reporting is generally on the increase among the world's top listed companies, Australia seems to be lagging behind in the voluntary disclosure stakes.

Top 100 listed companies issuing sustainability reports 2004/2005

Japan	**80% +**	**(72%)**
UK	**70% +**	**(49%)**
USA	**30% +**	**(36%)**
Canada	**40% +**	**(19%)**
Australia	**23%**	**(14%)**
South Africa	**18%**	**(data not available)**

Source: KPMG 2005

Notwithstanding the high number of reporters amongst the UK's top 100, the frequency of sustainability/triple bottom line reporting among other listed companies declines rapidly as one moves down the size scale.

[2] KPMG 2005 "International survey of sustainability reporting"

In an attempt to increase the level of purely environmental disclosures, the UK's Department for the Environment (DEFRA) has recently issued revised guidance on environmental reporting. [3]. DEFRA is attempting – like the Global Reporting Initiative – to standardise a number of key environmental KPI's in the expectation that standardisation will encourage greater disclosure.

All Governments could do more to encourage voluntary reporting and to support work on the standardisation of KPIs. At present such work is primarily carried out in the non-regulatory domain by bodies such as the Global Reporting Initiative (GRI). [4]

The GRI now claims to have over 700 companies worldwide acknowledging either that its 2002 reporting guidelines have influenced the preparation of their sustainability/triple bottom line report or that it has been prepared in accordance with the GRI guidelines. GRI is generally acknowledged as the global benchmark in terms of sustainability/triple bottom line reporting guidance and thinking.

The third generation of GRI guidance is due to be published in late 2006 and will result in an enhancement of the robustness of the performance indicators and a consequent improvement in the degree of assurability of the resultant reports.

The UK government has recently signified its tacit support for the voluntary approach espoused by GRI by engaging with GRI to identify specific areas where GRI and an inter-departmental corporate responsibility group of senior government officials can work together. We believe that the Australian government could do much to promote the GRI approach – especially in the run up to the launch of the GR guidance in 2006.

Influencing stakeholders

The only reason that triple bottom line reporting exists at all is because stakeholders have put pressure on companies to be more transparent as to their sustainability performance.

Governments can and should work with stakeholder groups to create a more informed and more engaged stakeholder community. The pensions and insurance sectors are particularly fertile ground because of the long-term nature of their activities.

Changes in UK pensions regulations a few years ago required pension fund trustees to make explicit statements regarding the extent to which they took social and environmental issues into account when framing their investment principles. This new requirement was tantamount to giving pension fund trustees a license to ask difficult questions.

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[3] UK DEFRA 2005 "Environmental Key Performance Indicators – Reporting Guidelines for UK Business"

[4] www.globalreporting.org

Given the long term nature of pension fund activity it is not surprising that that pension funds and the insurance industry have strongly and positively influenced the sustainability awareness of UK listed companies and the investment community.

The growth in the socially responsible investment (SRI) movement has also alerted companies to the potential difficulties associated with non or poor disclosure.

Greater public/stakeholder awareness is an important tool in encouraging greater transparency.

The creation of rankings and indices such as the FTSE4good and Business in the Community Index of CSR Engagement have been critical in publicising the relative performance of companies.

Reporting awards such as those sponsored by ACCA in the UK since 1991 also play a role in promoting the beneficial consequences of high quality disclosure.

Influencing management

The UK government has sought to engage with management in various ways:

- by creating business led-initiatives such as the CSR Academy and the new sustainable procurement task force
- by direct communication with corporate chairmen
- by linking disclosure of sustainability/triple bottom line issues to key business issues such as competitive advantage and risk management
- by threatening mandatory reporting if voluntary action did not succeed.

The relatively high number of large UK reporters may, in part, be due to the fairly consistent pressure exerted by UK government over the last 10 years.

Short of introducing mandatory disclosure requirements, governments have a limited range of options open to them other than the engagement and "soft law" technicques described above.

It has been suggested to us that one incentive which might contribute to improved CSR awareness and performance might be to introduce a clawback of incentive-based executive remuneration if a company incurs environmental or social liabilities for which full provision was not made at the time they were caused.

The grounds for this are as follows.

Currently, incentive-based compensation arrangements are heavily skewed to very short-term financial performance. Even so-called "long-term" incentives tend to consist of stock options that vest after only a few years. Under this system of rewards, it is not in the interest of managers to look to the long-term (ie, 10 to 50 years horizon) performance of their company, platitudes about sustainability notwithstanding.

One solution is to allow companies to reclaim performance-based compensation if it turns out that the actions taken under an executive's watch have led to unforeseen environmental or social liabilities. A company could decline to exercise this clawback only if there was no prospect of a substantial recovery.

Whilst we believe the idea has political merit, we note that, with the exception of Sarbanes Oxley in the US, public bodies charged with enforcing corporate governance around the world have generally refrained from introducing similarly punitive measures into their regulatory regimes. Nevertheless it remains an extreme option available to government.

F]. The appropriateness of reporting requirements associated with these issues.

ACCA believes that before governments begin to mandate triple bottom line reporting in the same way as they do financial reporting they must first be satisfied that

- There is consensus as to what should be disclosed
- Robust and reliable recognition and measurement techniques exist to capture the required disclosure data
- Generally accepted assurance methodologies have been developed to add to the credibility of reported triple bottom line data.

ACCA believes that developments in audit and assurance and the forthcoming Generation 3 (G3) of the GRI sustainability reporting guidelines will take us nearer to the point where some of the arguments against mandatory sustainability/triple bottom line reporting

- The reporting guidance on offer has not yet reached the "generally accepted" level
- The guidance on offer is too general and not sector specific
- The absence of assurance method undermines the credibility of the published reports

will begin to fall away.

We noted above that there are no obvious "rivals" to the GRI guidelines. We strongly recommend that governments everywhere recognise the benefits of the GRI's multi-stakeholder approach and seek to engage positively with GRI rather than attempting to replicate or reinvent a reporting framework which has taken nearly ten years and many millions of dollars to bring to its current, admittedly still imperfect, state.

A particular area of GRI's activity which would strongly benefit from greater government involvement is the development of sector specific sustainability reporting guidance to complement the generic nature of the core GRI guidance. GRI has currently developed about 10 sector guidance supplements – the intention being to increase the relevance – and consequently the attractiveness – of public reporting from both reporter and stakeholder perspectives.

The EU, for example, was a prime funder behind the GRI telecoms sector supplement and the Dutch government has funded the recent guidance for applying the GRI guidelkines to the SME sector.

G].	**Whether regulatory, legislative or other policy approaches in other countries could be adopted or adapted for Australia.**

ACCA does not believe that sustainability reporting guidance should be developed on a piecemeal national basis – hence our long-term commitment to the GRI. Nor do we believe that national accounting standard setters are appropriate organisations to host triple bottom line reporting responsibilities since they lack familiarity with many of the key issues which lie at the heart of sustainability reporting, such as stakeholder engagement.

Rather we recommend that national governments endorse the continued development of the GRI Guidelines so that it becomes a de facto global triple bottom reporting standard. In the same way that governments globally have accepted the legitimacy of the International Accounting Standards Board we believe that governments should explicitly support and contribute to the reporting and disclosure work of the GRI while at the same time seek innovative ways of engaging with both stakeholders, corporate management and the research community to demonstrate the value associated with a positive response to the CSR debate.

Conclusion and recommendations

- Governments can, as the UK company law review has demonstrated, both raise the awareness of the scope of directors' responsibilities and amend the law in relatively non-controversial ways in order to achieve greater acknowledge of the needs of non-financial stakeholder groups

- Governments should seek to capitalise upon new developments in mainstream financial reporting such as the "Management Commentary" to promote a range of socially responsible policy and risk disclosures

- There are many options available for stimulating the demand for sustainability/triple bottom line data and governments generally could do more to engage with potential stakeholders to assess their needs and develop pro-disclosure initiatives

- Mandatory sustainability/triple bottom line reporting should generally be avoided unless the mandate is for reporters to apply the independently developed reporting guidelines issued and periodically revised by the Global Reporting Initiative

- Governments should support the development by GRI of a wider range of sector specific reporting guidance

Annex *Triple bottom line reporting and the public sector – the NSW experience*

The earliest public sector reports were environmental reports. The first such report was produced by Sydney Water Corporation in the mid 1990s. The approach to sustainability reporting has been two-fold. One, moving to sustainability reporting from environmental reporting (eg. Sydney Water and State Forests), and two, moving straight to sustainability reporting (eg. Landcom).

Whilst the standard of public sustainability reporting has continued to improve within NSW Public Sector, there is a clear lack of consistency within the reports. Some remain environmental reports (eg. Sydney Catchment Authority and RTA NSW), others report in silos of environment, social and economic, whilst some are well integrated into core business (and within Annual Reports such as Landcom and Sydney Water). That said, the Global Reporting Initiative (GRI) is emerging as the most commonly-accepted platform for sustainability reporting within the sector. This will be further strengthened by the recent release of the DRAFT Public sector reporting supplement by GRI.

There is no over-arching regulatory requirement for sustainability reporting in the NSW Public Sector. However, specific legal instruments that apply to some of the agencies require some (varying) levels of public reporting (eg. Sydney Water, Landcom and Sydney Catchment Authority have specific legal requirements for reporting). Notwithstanding, regulatory requirements such as WRAPP and EEO, amongst others, that apply to the entire sector form the basis for some of the reported information.

The state and federal governments are looked upon by business to show leadership in broader social and environmental impact management and reporting. Indeed, some of these agencies are responsible for placing/encouraging such reporting requirements of business. Accordingly, it is important that the sector shows leadership by practicing transparency and disclosure. It is noteworthy that whilst some of the organisations mentioned above are producing voluntary sustainability reports, others have not yet even commenced the journey. This is alarming and shows inconsistency in policy within the public sector.

Several of the reports produced by the NSW Public Sector are independently verified. Independent verification provides internal and external assurance that the data and content reported, and claims made, are validated by an independent party. Indeed this is the feedback we have received from stakeholders of these reports, through structured feedback processes. The commonly accepted standard for assurance provision is the AA1000 Assurance Standard, now used by State Forests, Sydney Water and Landcom amongst others.

Recommendations

- Promote the use of the GRI, and GRI's Public Sector supplement in public sector reporting in NSW.
- Promote the use of the AA1000 Assurance Standard as appropriate guidance for independent assurance of public sector reports.
- Encourage, through voluntary and mandatory requirements, sustainability reporting by all NSW public sector agencies so as leadership is shown, and the NSW Public Sector is in par or leading other national and international public sector agencies in good environmental and social performance and reporting.
- Encourage and support sustainability reporting awards such as the ACCA awards (Sydney Water was the joint winner in 2003).
- Encourage reports produced to be independently verified, through a stakeholder engaged assurance process such as that undertaken with Sydney Water and Landcom in 2004.
- Produce a succinct framework for NSW public sector sustainability reporting that takes on board regulatory requirements, voluntary principles and emerging issues, within a platform of increasing consistency in reporting. This framework may form the shape of a code to which departments could become signatories, encouraging voluntary peer-led participation.