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

By email: corporations.joint@aph.gov.au

Dear Secretary

Inquiry into Corporate Responsibility

We refer to the call for submissions regarding the Parliamentary Joint Committee's Inquiry into Corporate Social Responsibility and attach our submission addressing each of the Terms of Reference.

We thank you for the opportunity to make a submission on this important area and trust our views will be of assistance to the Committee's inquiry.

The NSW Young Lawyers Pro Bono and Community TaskForce

NSW Young Lawyers is a division of the Law Society of New South Wales, a professional association in the State of New South Wales, Australia for lawyers under 36 years of age or in their first 5 years of practice. Consistent with the overall object of NSW Young Lawyers to assist disadvantaged groups in our community, a taskforce of volunteer lawyers and law students from diverse backgrounds have been set up to co-ordinate this function of our organisation. It is the mission of the Young Lawyers Pro Bono and Community Services TaskForce to:

(a) encourage, support and facilitate young lawyers to do pro bono and community services work;

(b) increase awareness of pro bono and community services and its role as part of our profession and the community;

(c) facilitate and participate in the broader debate about pro bono assistance in our community and reinforce the need for proper Legal Aid funding as pro bono assistance is not a substitute; and

(d) explore, collaborate and create innovative opportunities for Young Lawyers in the delivery of voluntary legal services to individuals and communities in need.

If you have any further queries in relation to our submission, please do not hesitate to contact me by reply email or on (02) 9947 6081. We would appreciate any opportunity to discuss our submission with the Committee. In the meantime, we request that the Committee keep us informed of the progress of the inquiry and any recommendations it makes to the Government.

Yours Faithfully,

Davyd Wong

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Submission by the
New South Wales Young Lawyers Pro Bono and Community Services Taskforce
to the
Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into Corporate Social Responsibility

September 2005

Terms of Reference

The Parliamentary Joint Committee on Corporations and Financial Services has been asked to enquire 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 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.

The TaskForce's Submission

The TaskForce has addressed each Term of Reference in order below. Throughout the submission, the terms listed below have the following definitions:

> **"stakeholder",** in respect of a particular corporation, means non-shareholder individuals and groups, including the wider community, which are or are likely to be affected (whether directly or indirectly) by the acts or omissions of that corporation. The definition extends from company employees to groups in other countries (for example, populations affected by pollution or climate change caused by the activities of corporations in other countries), to groups which may arise in the future (for example, a generation which may not be able to experience seeing certain environments or species due to destruction or extinction); and

“corporate responsibility” means the commitment of companies to contribute to sustainable economic development by considering and working with their stakeholders (based on the definition used by the World Business Council for Sustainable Development, 2004).

Term 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

1. It is difficult to accurately assess the level of existing regard organisational decision-makers have for the interests of stakeholders, due to the lack of requirements for triple-bottom-line or corporate responsibility reporting in Australia, and the lack of consistent definitions of the terms above (the *Corporations Act 2001* (**the Act**), for instance, contains no definition of "stakeholder", and related definitions in other legislation are unhelpful).

2. This submission therefore focuses on information voluntarily provided by individual companies and information provided by independent assessment and survey-style reports, with the unavoidable bias that the companies which choose to provide such information and respond to such surveys would tend to be the companies undertaking significant corporate responsibility activities, rather than the companies which do not undertake any such activities.

3. A further qualification of this submission, in relation to the reliance on self-reporting by companies, is that such reports tend to focus on successful stakeholder outcomes, rather than indicating the extent to which organisational decision-makers have regard to stakeholder interests when making decisions which affect the company. This submission does not attempt to comment on the completeness or transparency of self-reporting, but takes such reports at face value.

Reports and surveys

4. Several surveys support the fact that companies which publish reports on their corporate responsibility programs tend to be either larger domestic companies or companies with an international presence. Less evidence is available in relation to smaller corporations, as these do not tend to publish such reports. However, this may be due to lack of resources or information rather than lack of a sense of corporate responsibility.

5. From the available reports, it appears that many of the larger corporations in Australia do make some attempt to consider stakeholder interests, and some have well developed programs to address corporate responsibility (including Visy, Westpac, BP, BHP Billiton). As a whole, the performance by Australian companies is very mixed. The KPMG International Survey of Corporate Social Responsibility Reporting (2005) (**KPMG Survey –** report available at www.kpmg.com/Rut2000_prod/Documents/9/Survey2005.pdf) found that 23% of the top 100 companies in Australia publish information on their corporate responsibility activities (compared to 64% of the top 250 companies worldwide). The report by the Centre

for Australian Ethical Research entitled “The State of Sustainability Reporting in Australia 2004” (**CAER Report**) found a similar figure.

6. Internationally, the Ernst & Young survey entitled “Corporate Social Responsibility: A survey of global companies” (2002) (**E&Y Survey**) found that corporate responsibility is emerging as a significant business issue, with 73% of the companies surveyed (147 companies from the Global 1000) indicating it is high on the boardroom agenda, and 72% stating that they had or were developing corporate responsibility strategies. 73% of international companies surveyed by the Economist Intelligence Unit stated that their company undertook corporate responsibility activities, but only 15% said that corporate responsibility was a central consideration in most business decisions (reported in “The Way of the Merchant – Corporate Social Responsibility in Japan”, May 2005).

7. The Australian Corporate Responsibility Index run by the St James Ethics Centre (**CRI**) provides useful information on the level of corporate responsibility shown by companies in Australia – or would do, if more companies participated in the (voluntary) survey. Only 27 companies participated in the second CRI survey (reported in April 2005), from the more than 250 top Australian companies invited to do so – a response rate in the order of 10%. The less gruelling survey for the CAER Report had a response rate of approximately 20%. It is hard to avoid the conclusion that many of the non-responding companies (which are not small struggling companies) had either:

   (a) a lack of interest in the subject matter of the survey, reflected in a lack of internal resources allocated to answer the survey, or

   (b) a desire not to provide information which may not reflect well on the company.

8. As may be expected, the companies which did respond to the CRI survey showed a relatively high level of corporate responsibility activities. There are considerable differences in performance even among this self-selected high-performing group. Of the 27 companies in the second CRI survey, six achieved the highest score and six the lowest.

9. Professor Michael Adams, UTS, reports that “A survey of 98 of Australia’s leading corporates found that being a good corporate citizen was not generally seen as being central to core business or the way a company was organized or run” (presentation 2 August 2005, Sydney). Although companies may undertake some corporate responsibility activities, these may be seen as peripheral to the “real” business of the company. A company may dedicate some resources to undertake corporate responsibility activities, but the extent to which the company’s decision-makers consider the interests of stakeholders when making business decisions is another, and more difficult, question.

Other considerations

10. The motivations to undertake and report on corporate responsibility activities are reported to be a combination of ethical/philanthropic and business-oriented motives including reputation enhancement, risk minimisation, employee attraction and retention, and maintaining a strong market position (see the KPMG Survey and the CAER Report). Corporate responsibility programs tend to direct a company's philanthropy or ethical policies in a wide variety of ways most useful for the company.

11. The types of stakeholders which corporations consider include (but are not limited to):

    (a) employees;

    (b) disadvantaged individuals;

    (c) community groups and non-profit organisations;

    (d) public institutions;

    (e) other commercial groups or organisations, and

    (f) policy makers.

12. Companies may focus on one or two stakeholder groups or corporate responsibility areas such as the environment, health or education, often chosen in light of the company's core activities and markets, rather than undertaking a complete spectrum of corporate responsibility programs. Companies are increasingly considering their supply chain, in addition to actions taken directly by the company itself.

13. Differences in approach to corporate responsibility appear not only as a factor of the size of companies, but also in relation to their sphere of business. It appears that companies providing or relying heavily on physical resources or otherwise with significant environmental impact (for example, companies in the mining, energy or paper fields) tend to put more emphasis on corporate responsibility programs than service-based companies (see the KPMG Survey). Nonetheless, there has been an increase in corporate responsibility activity and reporting in the financial sector (KPMG Survey), also reflected in the success of Westpac in achieving the highest score in the 2004 CRI survey.

Impediments

14. The Taskforce submits that there are a number of factors impeding the ability of decision-makers to consider the interests of stakeholders in developing and implementing company policy. These include:

(a) the duty of directors to ensure companies make money for shareholders;

(b) competing stakeholder interests;

(c) lack of generally-accepted definitions of relevant terms, including “stakeholder” and “corporate responsibility”;

(d) lack of generally-accepted guidelines as to reporting corporate responsibility activities;

(e) a low rate of awareness in organisations as to their internal corporate responsibility agenda, which undermines effective incorporation of the interests of stakeholders by decision-makers. The international E&Y Survey found that “Only 19% of companies believe that their corporate responsibility agenda had been effectively promoted and understood throughout the organisation”;

(f) difficulties in ensuring that company decision-makers have complied with company policy in relation to corporate responsibility, in any one decision;

(g) economic constraints placed on a company by its shareholders, or by the perceived dictum that a company must act solely in the interests of its shareholders rather than stakeholders; and

(h) a lack of external reporting requirements, undermining the ability to track a company’s corporate responsibility performance against its stated policies.

Term of Reference (b)

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

1. As the Taskforce's submission in Term of Reference (a) indicates, the level of regard organisations have for the interests of stakeholders varies along a continuum, from those organisations which have no apparent regard for such interests, to those which evidence considerable stakeholder dialogue and engagement. In this submission, the Taskforce considers which point in the continuum is the most desirable, with regard to incorporated entities in Australia at this point in time.

2. It may be argued that the ideal point in the continuum varies depending on the type of organisation (its size, products or services and their by-products or environmental/social impact). It also depends on the group of stakeholders in question, particularly if stakeholders have conflicting interests. As a minimum, the Taskforce submits that all companies should as a matter of basic responsibility:

   (a) identify their stakeholders and the interests of each stakeholder group, and update these assessments regularly; and

   (b) as part of each significant business decision, assess the ways in which and extent to which those decisions, and more generally the company's activities, products, services and other impacts, are likely to affect those interests.

   Beyond this minimum, the Taskforce considers below the arguments for greater and lesser consideration of stakeholder interests.

Pros and cons: arguments for and against corporate responsibility

3. It is commonly argued that companies should only consider the interests of their shareholders, as these people have invested in the company or given up something of value which they risk losing. If a company focuses its resources on stakeholder interests, it is "cheating" its shareholders (see Gary Johns' 2002 Hal Clough Lecture, "Corporate social responsibility or civil society regulation?" available from the Institute of Public Affairs, and the article by John Blundell entitled "Companies exist only to trade – nothing else", available on www.iea.org.uk).

4. Under the definition of stakeholder introduced in the Taskforce's response to Term of Reference (a), all stakeholders risk losing something of value to them within the activities of the corporation. Shareholders may lose money whereas future generations may lose an

irreplaceable environment. Also, this future generation has “given” something of value to the company, assuming that the ability to use the finite environmental resources in question was useful to the company (see also the discussion of the commercial merits of social responsibility below – few shareholders today, if they were asked, would fail to recognise the valuable risk management and reputation enhancement functions of corporate responsibility, helping to maintain a company’s value over the long term).

5. Secondly, the Taskforce submits that companies are not the appropriate forum in which to resolve social problems as they do not have the appropriate expertise or resources. This is the province of governments, which are democratically elected. Allied to this is the view that corporate responsibility weakens democratic government (see Gary Johns’ paper above and his article “Insurance company whips up a storm” in the *Australian Financial Review,* 16 August 2005). These arguments lose force if the government legislates for corporate responsibility, as the Taskforce submits that it should do in response to Term of Reference (d). Furthermore, corporate responsibility does not require a company to become expert in new fields of environmental science or social policy – merely to understand and consider the effects that its own activities may have. The Taskforce submits that it is irresponsible for companies to undertake activities without such understanding.

6. Thirdly, there is the argument that companies are already obliged to consider the interests of certain stakeholders by extensive legislation dealing with employee rights, safety, anti-discrimination, privacy and environmental protection as well as other areas (see Gary John’s paper “Deconstructing corporate social responsibility”, 2005, Institute of Public Affairs). However, the very specificity of most such legislation (while it is still of benefit) encourages a compliance mentality, where companies aim to comply with the letter of the law rather than incorporating corporate responsibility principles more centrally into the company (see also the Taskforce’s response to Term of Reference (a) in relation to the extent to which companies have an existing regard for stakeholder interests).

7. A further argument that companies should have regard for the interest of stakeholders is the fact that in certain spheres, large companies today are richer and more influential than many governments, and can have an enormous effect on local communities, the environment and other stakeholder interests. Considering the number of people a multinational company employs, the resources it uses, its supply chain, the effects its products or services have on communities, the waste products it produces, companies can no longer be seen as merely an artificial form of private person.

Commercial reasons in favour of corporate responsibility

8. The following factors lend weight to the argument that organisational decision-makers, in the direct interests of their company should take into account stakeholders' interests in business decisions:

   (a) an effective form of risk management: dialogue between organisational decision-makers and stakeholders allows for the development of problem solving mechanisms and improves the overall quality and effectiveness of organisational decisions, as stakeholder input at an early stage may indicate community expectations and help resolve problems before they pose significant difficulties for the company or the community;

   (b) a commercial advantage for the company: such dialogue also provides a degree of transparency and allows some stakeholder monitoring of business transactions, which is likely to enhance the company's reputation and give rise to better relations with community members / customers / target audiences; and

   (c) as employees and potential employees are increasingly demanding that their employers are socially responsible, a company which demonstrates its high level of corporate responsibility and sensitivity to stakeholders may become an employer of choice.

9. Institutional investors are increasingly recognising the above factors and are starting to take a company's level of corporate responsibility into account for investment purposes. This is a further reason for companies to improve their performance in this area (see generally on these issues: Brad Howarth article "Character building", *Sydney Morning Herald* 23 July 2005; Andrew Cornell and Bill Pheasant article "Sick of red tape, keen for social action", *Australian Financial Review* 11 April 2005; Juno Consulting paper "Making sense of corporate social responsibility", 2004, available on www.junoconsulting.com.au; Chris Barry article "CIS green fury at Exxon boss", *Manchester Evening News* 26 May 2005).

10. As a minimum, the Taskforce submits that companies should identify stakeholder interests and how they may be affected by the company's activities. We suggest that a greater level of consideration of stakeholder interests (for example, by undertaking stakeholder dialogue) is justified by the great influence of companies in society today and by the commercial reasons in favour of such consideration.

Term of Reference (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

Care, skill and diligence

1 The current legal framework, the Act, states that directors must show reasonable care and diligence and act in the interests of the company and for a proper purpose. This includes the duty to act with reasonable care and diligence (s180), in good faith in the best interests of the company and for a proper purpose (s181) and not to improperly use their position or information (ss182/183). The Act has codified directors' duties to reflect the judicial decisions that all directors are expected to take reasonable care to guide and monitor the management of a company (*Daniels v Anderson* (1995) 37 NSWLR 438).

2 Directors must make a business judgment in good faith for a proper purpose, have no material personal interest in the matter, inform themselves appropriately, and rationally believe that the judgment is in the company's best interests: s180(2). The business judgment rule ensures that directors are responsible for the risks that they take and are not shielded from liability. Under the current framework, directors must not improperly use their position or any company information in any way to gain an advantage for themselves or to harm the corporation.

3 It is acknowledged in the decision in *ASIC v Rich* [2005] NSWSC 62 that directors have a special role to "articulate and apply a standard of care that reflects community standards" and that the standard has been raised "over the last century or so". It was acknowledged in this decision that these responsibilities are not part of the current legal framework.

4 With reference to the Jackson Inquiry (in relation to the James Hardie company), it is argued that the current legal framework encourages directors to ignore the interests of stakeholders because their legal duties are to achieve what is in the best interests of their shareholders. In the James Hardie example, the corporation relocated to The Netherlands, while simultaneously undermining the interests of asbestos victims by under-funding the Medical Research and Compensation Fund, a separate company set up by James Hardie to compensate victims. As a result, the corporation faced financial as well as social condemnation for upholding and protecting the interests of its shareholders over the interests of other stakeholders (i.e. its victims).

5 Since 1 July 2004, publicly listed companies in Australia have been required to have in place and post on their website, a Code of Conduct and Ethics indicating how they intend to deal

with stakeholder concerns and interests. However, this is not stated anywhere in the Act with respect to directors' duties.

Directors' fiduciary duties

6 Through the current legal framework, directors have a fiduciary relationship with their corporation (ASX Principles of Good Corporate Governance and Best Practice Recommendations). Fiduciary obligations often arise where one person is under an obligation to act in the interests of another, but this does not necessarily mean that the obligation to act in the interest of another is a fiduciary obligation (*Aequitas v AEFC* (2001) 19 ACLC 1,006). The provisions of the Act supplement the fiduciary duties, however the fiduciary duties, being the general law and not statutory, do not apply to other officers as defined in s.9 of the Act such as a secretary, a de facto officer, or person administering a compromise or arrangement involving the corporation.

7 Generally, directors owe fiduciary duties to the company and its shareholders and not, for example, to stakeholders such as creditors or minority shareholders (*Percival v Wright* [1902] 2 Ch 421; *Southern Cross Mine Mgt v Ensham Resources* (2004) 22 ACLC 724). Therefore a company may enforce fiduciary duties owed by a director. A reason for this is that otherwise, directors would be liable and exposed to a multitude of actions (*Brunninghausen v Glavanics* (1999) 17 ACLC 1,247 at 1,254 per Handley JA).

8 Directors must "have regard to the interests of the members of the company, as well as having regard to the interests of the company as a commercial entity": *Darvall v North Sydney Brick & Tile Co Ltd. & Ors* (1988) 6 ACLC 154 per Hodgson J. So in some circumstances directors' fiduciary duties may be extended, for example where directors issue new shares to advance their own interests and disregard the interests of their shareholders (*Ngurli Ltd v McCann* (1953) 90 CLR 425).

9 The exceptions to the general rule that fiduciary duties are only owed to the company are limited and can be categorised as follows:

(a) where there is a voluntary assumption of trust and confidence by the directors, e.g. where directors encourage shareholders to have trust and confidence in them such as when they hold themselves out to shareholders as acting as their agents;

(b) special facts, i.e a director has sole control of information about the matter that gives that director a "special opportunity" to exercise that advantage to another's detriment (*Brunninghausen v Glavanics* (1999) 17 ACLC 1,247).

Directors' duty to creditors

10 Section 588G of the Act is designed to protect creditors by dealing with the criminal liability of directors for insolvent trading by their company. A director contravenes s588G if the

director had reasonable grounds for "suspecting insolvency". This requirement of "suspecting insolvency" requires a director to predict the company's future financial capacity.

Directors' wider duties

11 Critics of corporate responsibility say that it takes too much focus off the bottom line (Chapman F "Corporate Governance and CSR – one vision for all" (2005) 8(5) IHC). Ultimately, a director of a company must obey the law in running that company in the best interests of its shareholders. However, the shareholders do not include the community, environment or greater public. The current legal framework does not take into account the interests of stakeholders other than shareholders and creditors.

12 Interestingly, companies believe that their duty to the community consists of complying with the law. If directors choose to put their the interests of the community (whatever those interests might be) ahead of the interests of the shareholders they would run the serious risk of being in breach of their present duties under the Act. The James Hardie example has further brought this issue into focus, regarding its dealings with those who contracted asbestos-related diseases as a result of contact with James Hardie products.

13 As environmental issues and directors' duties are not covered by the Act, recent cases suggest that the Courts are on occasion willing to look beyond the parameters of the corporation to consider the impact that company directors have on the community as a whole. The recent decision of *National Roads and Motorists' Association Ltd v Geeson* (2001) 39 ACSR 401 established that in particular circumstances, directors may have a "public duty" to act or refrain from acting in order to adhere to what is in the best interests of the community as a whole, rather than according to what is in the best interests of the company. The comments of Bryson J in this decision showed that it is possible for a common law duty to exist for directors to comply with principles of sustainable development.

14 If directors are expected to run their companies taking into account the interests of stakeholders, then they must have adequate protection via a legal framework, so that they will not be liable to suits brought by shareholders on the grounds that the directors are breaching their duties to shareholders.

15 The Taskforce submits that unless directors' duties within the Act are widened to encompass duties to stakeholders other than shareholders, directors must continue to comply with the current framework and act in the best interests of their shareholders.

Term of Reference (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.

1. As our response to Term of Reference (c) noted, companies are not required to give consideration to any stakeholders, other than shareholders and, at times other persons in certain exceptional circumstances. Under the current legal framework directors will be prohibited from considering stakeholders if their interests conflict with those of the shareholders.

2. There are times where the interests of shareholders will conflict with those of stakeholders. Particularly with consideration to the cultural change that has emerged from the Jackson Inquiry and the current CAMAC Inquiry, it is important for directors and entities to, at a minimum, have the opportunity to act in the interests of stakeholders in these circumstances of conflict. There must be revisions of the current legal framework so that where there is a conflict, directors and entities have a clear power to act in the interests of stakeholders that are not covered by the current legal framework.

3. There is a lot of uncertainty about when a conflict does arise, often as shareholders' interests are measured with consideration to short-term results, whereas the interests of stakeholders tend to be long-term. This uncertainty discourages directors from acting in the interests of stakeholders, even where there may be the desire to do so.

4. The Taskforce considers that, to ensure that entities and their directors are either enabled or required to consider stakeholder interests, the legal framework must be revised. The revisions must alter the current effect of the provisions of the Act and the most appropriate mechanism for doing this is to make an amendment to the Act itself. This legislation must determine the rights and obligations of entities and its directors, and changes to enable or require stakeholders to be considered should be incorporated into the Act.

Duty upon directors not to adversely affect the interests of stakeholders

5. One alternative is to amend the duties of the directors to incorporate a duty that the conduct of the entity does not adversely affect the interests of stakeholders. This would require the interests of stakeholders to be considered in all aspects (see Bob Hinkley's 28-word amendment).

6. Such an amendment, while effective in ensuring that the interests of stakeholders will be considered, is a long-term objective. We support such a revision of the legislative framework in Australia but suggest a less burdensome amendment to the legislation in the short term.

Right to consider stakeholders

7. Another alternative is to amend the duties of the directors to consider the interests of stakeholders when determining what is in the best interests of the company, rather than create a whole new duty. Such an amendment would empower the directors to consider the interests of stakeholders, i.e. to make it a defence to a complaint that they had acted improperly and not necessarily contrary to shareholder interests (Bill Beerworth, "A modest proposal: recognise the existence of stakeholders", Company Director, December/January 2004-2005 at p.13).

8. There is an argument voiced by Tom Bostock that such an amendment would "require a director to consider corporate social responsibilities [that] will subjugate a board to the politics of trying to balance different interests and stakeholder concerns" (Tom Bostock, "Is Beerworth's proposal really so modest?", Company Director, December/January 2004-2005 at p.16). Here, Bostock queries how to judge stakeholder interests and meet subjective community expectations.

9. However, the Taskforce considers that while the balancing of various interests may be difficult initially, it is necessary in order to address the needs of the greater community.

Regulating corporate responsibility

10. The Taskforce submits that the Act must be amended to include the Australian Securities Investments Commission (**ASIC**) as the main regulator for ensuring directors and entities meet their obligations to the stakeholders and the broader community.

11. ASIC is already the main regulating body that enforces and gives effect to the Act to protect consumers, investors and creditors (see *ASIC Act 2001* s 1(2)(g) and "ASIC at a glance – Our role" link at www.asic.gov.au). They already have the appropriate mechanisms in place, which include extensive powers and functions under corporations legislation, and they are able to commence and conduct criminal and civil proceedings (there are various provisions in place, and most involve preservation of assets). This will ensure that any company which violates a rule of corporate responsibility will face some form of disciplinary measure. ASIC also uses the medium of the media and public publications to keep the public informed ("ASIC at a glance – Our role" link at www.asic.gov.au). This is instrumental in using public pressure to ensure principles of corporate responsibility are being taken seriously and being adhered to by companies.

12. ASIC's investigation and enforcement powers are not limited to the exercise of functions under the *ASIC Act 2001* (Cth). According to its statutory responsibilities and powers under the *ASIC Act* 2001 (Cth) Pt. 3, the ASIC is the principal complaints handling body. They receive complaints from numerous informal sources. This means that the public should feel able to make a complaint, especially as a consumer. The fact that ASIC is an independent Commonwealth government body would ensure that responses would be reasonably fair and uniform. They often initiate investigations at their own motion, especially as a response to media reports or the public interest. The ASIC holds the public interest as a top priority, and this is reflected in how they proceed in their investigations (however, such investigations may not involve the formal powers of Pt. 3).

Directors' duties

13. With reference to Term of Reference (c), legal change to accompany and continue to drive the cultural change taken from the momentum of the Jackson Inquiry and now the CAMAC Inquiry is being seriously contemplated. As discussed, the traditional view of directors' duties, as is captured in the Act, requires a director to act in the best interests of shareholders by maximising profits and not to consider social/environmental concerns outside of that context. In limited situations directors are required to consider interests of creditors (when in insolvency or near insolvency).

14. The Act is clearly the most appropriate framework in which to incorporate corporate responsibility obligations on directors. Australian companies are highly aware of compliance requirements under the Act and the regulator, the ASIC, administers a highly effective regime. Furthermore, the penalties under the Act are more appropriate than those that may be available under various environmental statutes for example.

15. The Taskforce submits (as also discussed in Term of Reference (g)) that a middle measure may be to follow the recent UK Company Law Reform Bill (introduced March 2005). Draft clause B3 of this Bill requires a director to act so as to "promote the success of [their] company for the benefit of its members as a whole", taking into account so far as is reasonably practicable any need of the company "to consider the impact of its operations on the community and the environment" (among other things).

Term of Reference (e)

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

Code of conduct

1. The Taskforce's preferred approach, as set out in our response to Term of Reference (d), is for the Act to be amended to set out a general principle that directors must consider stakeholders' interests.

2. However, an alternative mechanism which may enhance consideration of stakeholders' interests is a code of conduct. The Taskforce proposes a new code of conduct based on existing codes as advocated by the Australian Stock Exchange (**ASX**) and Standards Australia, but with application to all entities regulated by the Act. The Taskforce's focus however, remains on listed companies and trusts (whether listed on Australian markets or overseas) as the key players in the debate on corporate responsibility.

3. Measures need to be taken with multinationals to ensure that they are bound to the law if they are dealing with Australian retail investors. There are provisions in the Act that cover this, but a specific provision about this and abiding by corporate responsibility principles needs to be included.

4. The Taskforce considers that a largely aspirational code of conduct would provide little guidance to entities without particular industry guidance. Therefore, we suggest a principles-based corporate responsibility code of conduct should be supported by guidelines to be issued from time to time by ASIC (ASIC's power to do this derives from s 1(2) of the *ASIC Act)*. These guidelines will be developed in consultation with industry groups and would have no legal status.

Using an existing mechanism - ASX CGC Principle 10

5. In March 2003 the ASX Corporate Governance Council (**ASX CGC**) released the "Principles of Good Corporate Governance and Best Practice Recommendations". ASX listing rule 4.10.3 requires companies to disclose in the corporate governance section of the annual report the extent to which they have adopted the 28 recommendations.

6. 2004 was the first year that listed trusts and companies were required to provide disclosure against the ASX CGC Principles and Recommendations. A May 2005 report by the ASX on corporate governance practices reported in 2004 indicates that the average adoption rate for all ASX CGC recommendations for the whole market was 68% and almost 85% for the top-500 companies (ASX, "Analysis of Corporate Governance Practices reported in 2004 Annual

Reports", 16 May 2005). This indicates a clear acceptance of the principles at the board-room level. However, we note that most attention has centred on the form of disclosures against the recommendation, as opposed to the utility of such disclosures as an indicator of actual company performance (in relation to those recommendations).

7. Principle 10 provides that companies should "recognise the legitimate interest of stakeholders". Legitimate stakeholders are defined to include non-shareholder stakeholders such as employees, clients/customers and the community as a whole. Recommendation 10.1 requires a company to establish and disclose a code of conduct to guide compliance with legal and other obligations to legitimate stakeholders.

8. It includes guidelines for the content of a code of conduct as follows:

   (a) clear commitment by board and management to code of conduct;

   (b) responsibilities to shareholders and the financial community generally;

   (c) responsibilities to clients, customers and consumers;

   (d) employment practices;

   (e) obligations relative to fair trading and dealing;

   (f) responsibilities to the community;

   (g) responsibilities to the individual;

   (h) how the company complies with legislation affecting its operation; and

   (i) how the company monitors and ensures compliance with its code.

9. Such a code of conduct, based on notions of legitimacy, fairness and ethics, is intended to be used to "set the tone and standards of the company" and to "oversee adherence" to such notions.

10. The ASX notes that the virtues of a code of conduct are that they can assist the board in recognising legitimate interests and enable employees to alert management to potential misconduct (ASX CGC Principle 10, p 59).

11. Although the ASX reports that levels of adherence to the ASX CGC Principles are high, the May 2005 report contained little discussion of disclosures made against recommendation 10.1 and no discussion of specific adherence to that recommendation. The ASX directs companies and trusts to Standards Australia's Draft DR03028 *Organisational Codes of*

Conduct, Draft DR03028 *Corporate Social Responsibility* and Draft DR 03029 *Whistleblowing Systems for Organisations* for further guidance on the content of a code of conduct.

Standards Australia

12. The TaskForce notes that Standards Australia's Standard on Governance (AS 8000-2003) also sets out the role of stakeholders in corporate governance. The Standard was drafted for all types of entities (listed and non-listed) and is quite similar to the ASX CGC principles. The TaskForce believes this standard could also provide the basis of a potential code of conduct.

Term of Reference (f)

The appropriateness of reporting requirements associated with these issues

1. Presently, the reporting framework in Australia on corporate responsibility matters is voluntary. Voluntary reporting has resulted in inconsistent, incomplete and biased information. Furthermore, the number of companies reporting on social and environmental matters remains few and far between. Social reporting is particularly worrisome (Doane, D. "Market failure: the case for mandatory social and environmental reporting", New Economics Foundation, available at www.corporate-responsibility.org).

2. The current statutory reporting requirements under the Act and the Australian Accounting Standards (**AAS**) issued by the Australian Accounting Standards Board (**AASB**) require an entity to report almost exclusively on the historical economic or financial performance of the entity during the financial year. (However, refer to sections 299(1)(d) and 299A of the Act.) While there has been a strengthening and extension of disclosure requirements since the introduction of the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (**CLERP 9**), there exists opportunity to strengthen the reporting requirements through the mandatory adoption of triple-bottom-line reporting in Australia.

3. Triple-bottom-line reporting is a reporting framework that has been voluntarily adopted by some Australian entities, and generally refers to the publication of an entity's economic, environmental and social performance, in addition to current statutory reporting requirements to disclose the financial or economic information. While there has been some uptake in voluntary triple-bottom-line reporting, there exist strong advantages in providing a mandatory triple-bottom-line reporting framework in Australia.

4. Advantages of mandatory triple-bottom-line reporting include:

   (a) providing for a transparent and balanced reporting approach, including requiring information that is both favourable and unfavourable to a corporation's image to be reported;

   (b) improving comparability of reporting information between different entities;

   (c) allowing information to flow to a broader stakeholder audience;

   (d) improving corporate reputation;

   (e) allowing the benchmarking of performance and facilitating international competitiveness;

(f) attracting and retaining high-quality employees by demonstration that an organisation is focused on its long-term existence;

(g) increasing access to investors and ethical funds;

(h) providing for sustainability and long-term economic survival;

(i) favourable economic performance (see "Sustainability Reporting: Practices, Performance and Potential" CPA Australia, July 2005);

(j) enforceability;

(k) more simplified processes – by limiting reporting to investors and other stakeholders, mandatory reporting would establish a definable standard for business and minimise transaction costs in responding to various queries relating to social and environmental performance; and

(l) reduction in costs by limiting spin through the production of high-cost PR reports, focusing business on the management issues at hand and including this information tin the annual report to shareholders.

5. Disadvantages of triple-bottom-line reporting include:

(a) increase in annual reporting costs with disproportionate costs to smaller business;

(b) potential exposure to risk and liability in relation to the reliability of the triple-bottom-line report's content (which could be overcome by mandatory auditing of the triple-bottom-line reports);

(c) while there has been some successful voluntary adoption of triple-bottom-line reporting in Australia, studies have indicated that there exists potential bias in the current voluntary presentation of triple-bottom-line reporting in Australia, which has observed the inclusion of information that in some cases is limited to only favourable environmental and social reporting information; and

(d) similarly, the usefulness and comparability of triple-bottom-line reports between different entities has been limited, after studies of disclosures made by a number of publicly listed companies show that disclosures range significantly in content and quality.

6. It is the Taskforce's view that triple-bottom-line reporting should be mandatory for incorporated entities in Australia, since the current reporting requirements and voluntary

triple-bottom-line reporting is not adequately achieving meaningful and consistent reporting information for a broader range of stakeholders.

Current reporting requirements

7. Current reporting requirements under the Act and the AAS have the force of law under section 295(2)(a) of the Act. The financial statements and notes are those required by the AAS. In addition, the notes must include any other information that is necessary to give a "true and fair" view of the financial position and performance of the company (pursuant to section 297 of the Act). The directors' declaration must involve the director declaring whether the financial statements are in accordance with the AAS, and if the "true and fair" view requirement in section 297 primarily focuses on the entity's requirements to report predominantly historical economic performance in the annual financial report and director's report.

8. The requirement in section 297 of the Act is mirrored in the AAS (AASB 101 "Presentation of Financial Statements" (15 July 2004)). Paragraph 13 states:

> [a] financial report shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. The application of Australian Accounting Standards, with additional disclosure when necessary, is presumed to result in a financial report that achieves a fair presentation.

9. However, the requirement to provide a "true and fair" view is applicable only to the economic aspect of a company's performance rather than including the broader environmental and social performance envisaged by triple-bottom-line reporting.

10. While there does exist a mandatory requirement to provide some environmental reporting in the entity's annual director's report under section 299(1)(f) of the Act, there has been ambiguity in practice as to the nature and extent of this legislative requirement. The application of section 299(1)(f) is uncertain due to the meaning of particular and significant environmental regulation. It could potentially mean either an environmental regulation, which has particular application only to the reporting entity. Alternatively, it could involve the reporting entity being subject to an environmental regulation, which has general application within the jurisdiction but has "particular" significance to the reporting entity by reason of the nature or extent of its operations:

> The directors' report for a financial year must - if the entity's operations are subject to any particular and significant environmental regulation under a law of the Commonwealth or of a State or Territory – give details of the entity's performance in relation to the environmental regulation.

11. While this requirement appears to require companies to account for their environmental performance, research indicates that disclosure is more common for companies in the materials, capital goods and energy sectors and those that are subject to regulatory regimes, for example, the *Fuel Quality Standards Act 2000*, the *Environmental Protection (Diesel and Petrol) Regulations 1999*, and state environmental legislation such as the *Protection of the Environment Operations Act 1997* (NSW) ("Sustainability Reporting: Practices, Performance and Potential" CPA Australia, July 2005). Furthermore, the research has indicated that the disclosure practices range in format, quality and scope with some companies providing very little information due to the ambiguity of the extent of environmental reporting that is required.

12. Although some entities are faced with this mandatory environmental performance reporting obligation, there exists little or no mandatory requirement for entities to report information pertaining to social performance.

13. Similarly, there is no requirement in the AAS that the environmental and social information relating to the entity's transactions and events must be reported on in the financial report. AASB 101 "Presentation of Financial Statements" states at paragraph 10:

> Many entities also present, outside the financial report, reports and statements such as environmental reports and value added statements, particularly in industries in which environmental factors are significant and when employees are regarded as an important user group. Reports and statements presented outside the financial report are outside the scope of Australian Accounting Standards.

14. Section D of the KPMG Survey identifies codes, standards and guidelines used in many jurisdictions worldwide. Any mandatory reporting scheme introduced in Australia should have regard to reporting standards in these jurisdictions, with a view to making multinational companies accountable and reporting by these companies consistent. Section 2.4 of the KPMG Survey discusses trends in corporate responsibility reporting by sector. The results clearly show that reporting on corporate responsibility matters varies in each industry sector. Further, the report identifies that disclosure is then often selective and restricted to certain issues.

15. Section 299A of the CLERP 9 has strengthened to some extent the pre-existing reporting requirements (see sections 297 ("true and fair view"), 299(1)(d) and 299(1)(3)), by requiring the annual directors' report for a listed public company to include:

> information that members of the company would reasonably require to make an informed assessment of:
> (a) the operations of the entity reported on; and

(b) the financial position of the entity; and

(c) the entity's business strategies and its prospects for future financial years.

16. While this has strengthened the pre-existing reporting requirements, this reporting requirement is not adequate for two reasons:

(a) it has limited application, namely to listed public companies; and

(b) section 299A(3) of the CLERP 9 qualifies the requirement in allowing the omission or non-disclosure in the directors' report of the information on "the entity's business strategies and its prospects for future financial years" as required by section 299A(1)(c):

If it is likely to result in unreasonable prejudice to:

(a) the company or disclosing entity; or

(b) if consolidated financial statements are required—the consolidated entity or any entity (including the company or disclosing entity) that is part of the consolidated entity.

17. Therefore, unfavourable economic, environmental and social information can be omitted from the statutory accounts, subject to the mandatory environmental reporting requirement under section 299(1)(f) of the Act.

Product disclosure statements

18. Since 11 March 2004, s1013D(1)(l) and the regulations to the Act [7.9.14C] contain obligations for all investment product issuers to disclose information about labour standards and environmental, social and ethical factors in product disclosure statements (PDSs) of investment products.

19. Section 1013DA of the Act states that ASIC may develop guidelines where a PDS claims that labour standards or environmental, social or ethical considerations are taken into account in the selection, retention or realisation of the investment.

20. The Taskforce notes that the ASIC has also developed guidelines for the inclusion of information relating to labour standards and environmental, social and ethical factors in PDSs of investment products (ASIC Media and Information Releases "ASIC releases final socially responsible investing guidelines" 17 December 2003). These guidelines stem out of reforms to the Act requiring investment products to disclose this information in PDS.

21. These guidelines are aimed at product issuers in allowing them to determine for themselves particular factors and the methodology involved with labour, social or environmental standards. The Taskforce further notes that ASIC intends to review these guidelines in 2006

(ASIC Media and Information Releases "ASIC releases final socially responsible investing guidelines" 17 December 2003).

Global Reporting Initiative

22. The Global Reporting Initiative Guidelines (2002) are for voluntary use by organisations for reporting on the economic, environmental, and social dimensions of their activities, products or services (a copy of the Global Reporting Initiative Guidelines is available at: www.globareporting.org/guidelines).

23. The presentation of voluntary triple-bottom-line reporting in Australia using the Global Reporting Initiative Guidelines has encompassed one of three forms ("Sustainability Reporting: Practices, Performance and Potential" CPA Australia, July 2005):

    (a) an integrated approach whereby the environmental and social information is integrated into the entity's economic performance as disclosed in the entity's statutory annual report, or

    (b) a segregated approach whereby the environmental and social information is provided by way of a stand-alone discrete report, or

    (c) a combination of the entity including some environmental and social information both in the statutory annual report, and also, on a stand-alone basis.

24. The Global Reporting Initiative Guidelines comprise a total of 40 indicators (16 core environmental indicators and 24 core social indicators). The problem with the Global Reporting Initiative Guidelines is that, like the Australian Public Environmental Reporting (**PER**) Framework, it remains a voluntary scheme. (In March 2000, "A Framework for Public Environmental Reporting - An Australian Approach" was published by Environment Australia in conjunction with the National Heritage Trust. Copies of the PER Framework can be obtained at www/environment.gov.au/epg/environet/eecp/publications.html.) Consequently, companies cannot be compelled to report against its standards. Consistency in reporting is, however, crucial to transparency. It is therefore vital that Australia has regard to the Global Reporting Initiative and to foreign mandatory reporting standards. Foreign standards of particular note include those in the United Kingdom (under the recent amendments to company law, introducing the "Operating Financial Review" (see www.icfconsulting.com/Publications/Perspectives-2004/uk-ofr.asp)) and those in the United States of America (under the *Sarbanes Oxley Act*), which appear to be among the more developed mandatory reporting requirements, even if these standards are not specifically focussed on corporate responsibility.

Barriers to the implementation of mandatory triple-bottom-line reporting

25. It is argued that mandatory reporting may impose a significantly higher compliance burden than would be justified by the principle that mandatory regulation should be the minimum necessary to achieve the set objectives.

26. It is also argued that regulatory provisions might impose additional costs on top of the established regulation, for little or no tangible benefit, with substantial risk of uncertainty and litigation. The risk of litigation arising from misleading disclosures and enforcement action will mean that moves to introduce any mandatory reporting requirements are likely to meet with strong business opposition.

27. Notwithstanding the above arguments, the Taskforce considers that these potential barriers should not be heralded as grounds for not implementing mandatory reporting. Increased costs are a perception only and are likely to be more than offset by risk reduction, increased stakeholder confidence in the reporting entity and costs savings arising from understanding what does and doesn’t need to be reported. Costs arising from litigation are likely to be few and far between and enforcement costs are costs that should be properly borne by an entity failing to comply.

Term of Reference (g)

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

1. Countries in Europe and to a lesser extent, North America, have designed and implemented numerous initiatives in an effort to promote corporate responsibility both domestically and internationally. Of these initiatives, the Taskforce considers the following could be adopted or adapted for Australia.

European initiatives

France

2. France has been very active in the corporate responsibility arena, particularly through regulatory initiatives which make corporate responsibility an integral part of the workplace and financial market.

3. France mandates triple bottom line reporting for publicly listed companies, by law. The law requires a listed company to state in its annual report how it takes into account the social and environmental consequences of its activities. The law also obliges companies to report on a set of qualitative and quantitative social indicators which have been drawn by decree. However, the law does not prescribe the guidelines for reporting.

4. Similarly, the laws governing public pensions and employee savings plans require the disclosure of social, ethical or environmental criteria used for investment.

5. France also requires companies to report on community issues, including the impact of their activities on local development and local populations, how they engage with local stakeholders such as environmental NGOs, consumer groups and educational institutions. The companies must also report on their overseas subsidiaries and sub-contractors complying with ILO core labour conventions.

Germany

6. Germany has a number of approaches in place in order to encourage the use of corporate responsibility practices by companies.

7. The German federal government offers benefits and incentives to apply a European community scheme called the European eco-management and audit scheme (**EWAS**). EWAS includes agreeing to environmental supervision, reporting requirements, notification

duties regarding corporate organisation and emission measurements. The voluntary scheme was popular with 2600 German EWAS-certified companies in 2004.

8. The German federal government has also set up a website to inform consumers about fair trade, which features the companies, organisations and products in this field. This website demonstrates a practical approach by the government to encourage companies to adopt corporate responsibility initiatives.

9. The German federal government has also signed an agreement with German industry to promote gender equal opportunities in the private sector, such as best practices, advice for companies, and integration of equal opportunities and family friendly policies in training materials and corporate consulting.

10. The German export ministry promotes corporate responsibility-friendly guidelines, namely the OECD guidelines, through its export credit programme. The programme is voluntary and not mandatory.

11. In addition to the above initiatives, Germany has also legislated a requirement for all certified private and occupational pension schemes to report on whether or not they take into account ethical, ecological and social aspects in their investment policies.

United Kingdom

12. The United Kingdom government has set up a website on corporate responsibility. Although it is propaganda driven to some extent, the website actively promotes corporate responsibility and does contain some useful general information.

13. The United Kingdom government has proposed amendments to directors' duties requiring them to take into consideration the interests of a broader range of stakeholders (i.e. not just shareholders). One of the objectives for the current law reform proposal is to provide a legislative obligation upon directors to promote their companies by taking into account factors such as employees, effects upon the environment, suppliers and customers. Page 20 of the Company Law Reform White Paper (March 2005) states that:

> the basic goal for directors should be the success of the company for the benefit of its members as a whole; but that, to reach this goal, directors would need to take a properly balanced view of the implications of decisions over time and foster effective relationships with employees, customers and suppliers, and in the community more widely.

14. The *Pensions Act Amendment*, which came into effect in July 2001, requires trustees of occupational pension schemes to disclose the extent to which social, environmental or ethical considerations are taken into account in the selection of investments. This

requirement is similar to the obligations imposed on product issuers under s1013D(1)(l), s1013D(2A) of the Act and 7.9.14C of the regulations to the Act.

15. The *Environmental Information Regulations 2004* came into force at the beginning of this year and requires public authorities to make a broad range of environmental information held by them available to the public. The expansion of this into the private sector in respect of Australian publicly listed companies may be of interest.

Belgium

16. Belgium, like a number of other European Union countries, has introduced a voluntary social label, by law. Under the law, a company can acquire a label as long as it meets a number of criteria and is examined by one of the bodies accredited by the Belgian Minister for Economic Affairs. A company applying for the label for one of its products has to submit information on all suppliers and subcontractors directly involved with the making of the product.

The Netherlands

17. The Dutch government has implemented a number of initiatives to promote the use of corporate responsibility in the marketplace. Among these are:

    (a) a "green investment directive" that promotes access to finance for environmentally sound projects, and provides that the returns are exempted from income taxes; and

    (b) a requirement that companies applying for taxpayer-funded subsidiaries must declare in writing that they are familiar with the OECD guidelines on corporate responsibility, and that they will make an effort to apply them to their operations. The guidelines are voluntary and compliance with them is not monitored.

Austria

18. Among its many initiatives, Austria has developed a code for its travel and tourism industry which is a code of conduct for the protection of children from sexual exploitation in travel and tourism. The overall project which developed the code includes a training component, a clause in contracts with suppliers, information to travellers and reporting guidelines.

North American initiatives

Canada

19. Canada embraces the use of education and training initiatives to advance corporate responsibility. For example, the Canadian government has designed a broad-based website called Strategis, which provides corporate responsibility-related information to corporations

and consumers. It has also designed tools such as the Environmental Management Toolkit and Sustainability Reporting Toolkit, which educate and train businesses (particularly small and medium-sized) to improve on their corporate responsibility practices.

20. Canada also employs regulatory, economic and voluntary initiatives to advance corporate responsibility. Significantly, all federally regulated financial institutions with capital assets in excess of $1 billion are required to issue an annual Public Accountability Statement which describes their contribution to the economy and society, and all corporations listed on the Toronto Stock Exchange are required to adopt a code of ethics. Corporations also have a choice to register their greenhouse gas emission performance on the Voluntary Challenge Registry, and receive public recognition for it.

21. Canada recognises that its corporate responsibility initiatives will need to evolve over time. It has created a post for the Commission of the Environment and Sustainable Development, to monitor corporate responsibility in Canada. Furthermore, federal departments are required to produce sustainable development strategies every three years and table these in parliament. These actions are designed to ensure that corporate responsibility initiatives are effectively coordinated at the government level.

United States

22. The United States uses regulatory initiatives to increase the amount of information a company is required (or expected) to disclose, in relation to its environmental and social performance.

23. For example, the United States Securities and Exchange Commission requires corporations to disclose actual or contingent environmental costs, such as those relating to site clean-up or remediation and potential claims or penalties. Also, the *Sarbanes-Oxley Act* requires United States listed corporations to disclose whether they have adopted a code of ethics for Chief Executive Officers and senior financial officers to follow, and also requires senior executives to assure the legitimacy of performance reports (by signing off on them).

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