

# The social responsibility of corporations

Recent trends and future developments in the  
promotion of responsible business practices

June 2011

CPA Australia Ltd ('CPA Australia') is one of the world's largest accounting bodies representing more than 132,000 members of the financial, accounting and business profession in 111 countries.

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First published  
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ACN 008 392 452  
Level 20, 28 Freshwater Place  
Southbank Vic 3006  
Australia

ISBN 978-1-921742-14-9

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# Background

In 2006, two watershed reports into the conduct of corporations in Australia were released. The first, released in June 2006 by the Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS) was *Corporate responsibility: Managing risk and creating value*. The second, released in December 2006 by the Corporations and Markets Advisory Committee (CAMAC) was *The social responsibility of corporations*. Both reports were prompted by a combination of factors; predominantly the conduct of James Hardie Industries and growing international trends around concerns as to the environmental and social impact of business. CAMAC, as a body constituted under the *Australian Securities and Investments Commission Act 2001*, is the principal body vested with advising the government on matters of corporate law reform. The CAMAC report, unlike the PJCCFS's, does not contain specific recommendations, but is a rich source of technically based material addressing the then current state of understanding as to the role of the corporation in both a business and wider social context. Typical of CAMAC's balanced approach, the central conclusion drawn is that:

“Companies should be judged on the way they conduct themselves in the context of pursuing their business aims and their overall economic and other contributions and impacts. This includes the way they deal with environmental and social issues that relate to their business. They should not be expected to direct their efforts to social ends regardless of the relevance of those ends to their own business.”

(CAMAC media release 12 December 2006)

The CAMAC report is structured around four key chapters:

1. The international context
2. Duties of directors
3. Corporate disclosure
4. Promotion of responsible practices.

This review from CPA Australia concerns the latter two of these issues as the ones most germane to St James Ethics Centre and those that have the greatest direct bearing on international developments since the release of the report. CPA Australia makes the following specific suggestions for consideration by St James Ethics Centre as part of its reporting to government on the state and circumstances of responsible business practice in Australia:

- The Australian Government, through Treasury, actively pursue developments in integrated reporting, particular given the International Integrated Reporting Committee's intentions to develop criteria for regional coverage and to present a framework proposal to the G20 November meeting in 2011. Further, that appropriate funding be provided to the Australian Accounting Standards Board (AASB) to pursue this major development in the national interest.
- The Department of Sustainability, Environment, Water Population and Communities be provided with short-term funding to investigate the suitability of the Economics of Ecosystems and Biodiversity (TEEB) as a component in the development of current and future cycles of state of the environment reporting, and as a basis for assisting related environmental policy development.
- That government agencies be required to prepare sustainability reports and incorporate such reports in their annual reports to the Parliament of Australia. Such sustainability reports should be prepared in accordance with current guidelines.
- That the government provide financial support for specific projects that might arise from time-to-time under the umbrella of GRI Focal Point Australia.
- For the benefit of Australian businesses seeking to respond positively to the trend towards higher quality and more integrated disclosures, there be a Global Reporting Initiative National Annex or similar developed, with government assistance, that would assist in mapping the existing array of corporate environmental, social and governance (ESG) disclosures as a basis for simpler and more efficient reporting.
- That there be promoted, from a combination of sources, financial support for the ongoing development of the Good Business Register® presently housed at the St James Ethics Centre.
- The government fund the establishment of a Sustainability Commission to set sustainability targets for Australia and monitor performance against those targets.
- The government direct the Sustainability Commission to draft a sustainability charter to shape behaviour on sustainability.

# The changing context of corporate social responsibility

The fact that our understanding of corporate responsibility is not static, and thus influenced by a complex interaction of factors, is amplified by the following remark contained in CAMAC's introductory analysis:

## Resolving the social responsibility conundrum

*The notion of corporate social responsibility is an elusive one. It raises questions of to whom and in what way companies are accountable. Heightened interest in the way that companies conduct their activities is understandable and is to be welcomed. At the same time, care needs to be taken in discerning various viewpoints on the role of corporations in society and their implications for corporate governance. A simplistic approach that focuses on one particular social perspective to the exclusion of others is unlikely to do justice to the complexity of corporate decision-making or the overall contributions of corporations to society. A balanced approach, under which companies are judged according to their overall economic and other contributions and impacts, including how they manage social and environmental issues relevant to their business, is more productive and meaningful.*

Within this theme of complexity, since the writing of the CAMAC report, clearly the most significant series of events shaping understanding and expectations about the role of corporations are those termed the global financial crisis (GFC). The GFC has focused considerable attention on a wide range of attributes of corporate governance among both national regulators and international agencies. This is aside from the extensive consideration given to the prudential regulation of bank and non-bank financial institutions, particularly in relation to issues of capital adequacy and the risk-rating of highly securitised mortgage backed debt instruments.

Corporate governance is predominantly effected through a combination of legislation, securities exchange listing rules and principle-based guidance ('apply or explain' or 'if not, why not' disclosures and underlying internal practices). The major issues considered in the realm of corporate governance across the past 18 months, both in Australia and overseas, are as follows:

- Executive remuneration – its level, extent of shareholder approval and better alignment with corporate goals.

- Executive termination payments – its level and particularly its validity in the circumstances of significant corporate under performance.
- The short selling of securities in instances where securities are trading ahead of title and delivery.
- Margin lending arrangements in instances where directors trade company shares through debt arrangements which require the director to pay the debt if the shares fall below a certain value.
- Trading in securities in blackout periods between financial reporting period end and public release of reports.
- Phoenix company activities in instances where assets are moved from one entity to another with the original company being wound up in insolvency.
- Adequacy of continuous disclosure regimes and director responsibility for content.
- Gender and diversity representation on boards.

Executive compensation (its level, growth, relationship to corporate performance and disclosure) has been a highly active area of governance debate in Australia and across the globe in the aftermath of the GFC. Executive compensation, and the related aspect of termination payments, are a significant topic in the development of governance. On the one hand, they are a mechanism of reward which aligns the behaviour of executives with the interests of the company and its shareholders. On the other hand, such payments present the risk of unreasonable wealth transfer from shareholders to executives. Based on ideas of transparency, the emphasis in Australia has been to focus on the moderating effect of comprehensive disclosure. This applies to information about the scale and structure of remuneration of key management personnel and a requirement that the link between remuneration structure and the generation of shareholder wealth be explained. Increasingly, there is a substantial shift in shareholder empowerment. This relates to both power to veto termination payments and the capacity to cause a spill of board positions in the event of successive rejections of remuneration reports.

Stakeholders should not lose sight of the fact that the very nature of the corporation, with its privileges of limited liability and separate legal personality, is directed at enabling the pursuit of economic gain with the disbursement of risk among an often large number of participants. Governance frameworks such as the ASX Corporate Governance Council Corporate Governance Principles and Recommendations and South Africa's King III directly acknowledge the wealth-generating objective. Different types of companies and different types of ventures will have different appetites for risk. Aside from ensuring the proper conduct of a company's affairs and enhancing capacity to comply with the black-letter and spirit of the regulatory environment, effective governance structure should also reflect ideas of safeguarding the long-term wealth-generating capacity of the company – in this way governance reflects the perpetual existence of the company. Governance mechanisms should never lead to management inertia and a refocusing of attention away from the sustainable generation of wealth. A further noteworthy attribute of best-practice governance is in the area of effective delegation of powers and the safeguards in relation to reliance on information and advice provided by others. This not only improves board performance and internal decision-making, but is also an important element in building succession.

The GFC, while highly precipitous in shaping our present understanding of corporate governance, occurred at the same time as the emergence of a consensus on the impact of over-consumption of finite natural resources and the very real risk of catastrophic climate change, coupled with grave concerns as to the viability and equity of our current economic models. For an example, one need only look at the contrasting extreme dire climate events occurring around the world and the recent failure of institutional governance practices that underlie both the human impact of financial institution failures in the US in 2008 and the problems of sovereign debt which, in 2009, commenced to beset a number of European governments.

The predominant economic model which we have today inherited emphasises high-consumption and high-waste. Closely associated with this are the wealth maximisation and shareholder primacy theories of the corporation. These features are further complemented by managerial behaviour which encourages a short-term outlook and celebrates a highly competitive win-at-all-cost style. It is in this and the above contexts that mainstream critical attention is being generated as to our ideas of what constitutes wealth, the equitability of its distribution and the, at times, adverse consequences of it being generated. The challenges to our accepted ways of conducting economic activity are captured in such works as Professor Tim Jackson's *Prosperity without growth? The transition to a sustainable economy* published in 2009 by the UK Sustainable Development Commission. Deliberate actions to redress our current circumstances, and their underlying assumptions, can be readily seen from the remarks of Sir Michael Peat, Principal Private Secretary to HRH The Prince of Wales and the Duchess of Cornwall and Chairman of the IIRC:

“Integrated reporting is a vital building block to enable the global economy to meet the challenges of the 21st century: to help the development of an economy which can maintain standards of living for people who already enjoy a good quality of life, and create them for the hundreds of millions who do not, without the present unsustainable over-consumption of the world's finite natural resources.”

(IIRC meeting, Beijing, January 2011)

The emergence of the integrated reporting initiative is discussed following.

The above combination of factors, while underscoring the steady rise of complexity to which corporations are exposed, focuses attention on the role of government in developing policy, which achieves both desired outcomes and promotes the essential role to be played by business in the steps towards a sustainable basis of economic prosperity. CPA Australia's views on potential positive development in this direction are contained in the following passages with reference to CAMAC's respective consideration of corporate disclosure and promotion of responsible business practices.

# Corporate disclosure

CAMAC's investigation of the state of corporate sustainability disclosure in 2006 is prefaced by the following introduction:

## Corporate disclosure

*This chapter considers whether certain types of companies should be required to report on the environmental and social impact of their activities, in narrative or quantified form. It outlines current reporting requirements, refers to developments in other countries, summarises the views and proposals in submissions and sets out the Advisory Committee's conclusions.*

The broad thrust of CAMAC's conclusions around the subject of corporate disclosure, was that transparency was the cornerstone of responsible business practice and that disclosure to the public of relevant information enabled interested parties to respond to the way a company's business was being conducted. This said, because of the formative stage of development, CAMAC was of the view that the various current streams of activity should be allowed to continue rather than cutting across with legislative prescription. The GFC has, to a substantial degree, overtaken this expectation of incremental development, focusing specific critical attention on the governance function of financial reporting, while more generally challenging the character and limitations of financial reporting.

Our current accounting standards and securities exchange listing rules do not adequately reflect material environmental and social factors, nor do they communicate the current and future performance of an organisation contributing to the creation of a sustainable economy. Financial reporting, which is predominantly past event and transaction focused, does not capture the full dimensions of corporate performance, risk and worth. These shortcomings are perhaps brought into greater relief when viewing the corporation as an essential element in identifying and pursuing positive environmental and social outcomes. Financial reporting in many, but not all, respects serves the objectives of market efficiency and disclosure of the stewardship performance of directors well – matters of vital concern to investors. Sustainability and social issues are reflected in financial reports to the extent that they are monetised and reflected in financial transactions. The problem for investors and wider stakeholders concerned about environmental and social risks is that the environmental and social attributes of a business may not be clearly apparent from these measures. Similarly, the time horizons over which environmental and social issues must be addressed are not reflected.

It is worth noting that the past decade has seen significant development in the quantification and monetisation of what was formerly economic and corporate externalities. As we have come to grips with carbon measurement and disclosure, we will likewise, over time, address measurement of critical environmental attributes such as water resources, biodiversity and impacts on ecosystems. Moreover, it should be remarked that while critical aspects of environmental, social and governance (ESG) performance may remain in the realm of intangibility, their presence cannot be ignored, and it is here that professional judgement is paramount. Also, one should not underestimate the role of transparent and efficient markets in pricing what would otherwise be treated as intangible.

The most significant recent development in the realm of corporate reporting is the establishment of the International Integrated Reporting Committee (IIRC). The IIRC is a collaborative initiative of the Amsterdam-based Global Reporting Initiative (GRI), the Prince of Wales Accounting for Sustainability Project and the International Federation of Accountants. The IIRC involves the participation of such significant groups as: the United Nations (UN) Environment Program, the UN Global Compact, the International Accounting Standards Board, the Financial Accounting Standards Board, the International Federation of Accountants, the World Resources Institute, the Climate Disclosure Standards Board and the International Organization of Securities Commissions. Each of the 'Big 4' international accounting firms are also involved, as well as the major professional accounting bodies, including those based in Australia.

At its August 2010 launch the IIRC stated that:

“An integrated report would present information in context and would encourage the alignment and linkage of financial, non-financial and narrative information in a form that enhances user understanding and insights.”

The integrated reporting model aims to bring reporting closer to the information used by management to run a business on a day-to-day basis. There will thus be a rebalancing of performance metrics away from an undue reliance on short-term financial performance. Against this, integrated reporting aims to provide a framework for the comparable reporting of all aspects of business including ESG factors. As such, integrated reporting will centre on the strategic and market context within which a business is operating and how this may change over time. Integrated reporting will break down what has, to date, been siloed development of different streams of

corporate disclosure. Moreover, transparency around the dynamics of the business model and the associated risks and opportunities that emerge will be provided, including environmental factors, such as climate change, use of finite resources, biodiversity and waste, and social factors, such as employee safety, ethics and human rights. It must be emphasised that rather than increasing the reporting burden, integrated reporting will rationalise corporate disclosure and make it more accessible.

A significant number of Australian groups representative of the accounting profession and accounting practice, including CPA Australia, will be actively involved in the development of integrated reporting. However, CPA Australia sees a coordinated Australian approach as most beneficial in the promulgation of international developments of this nature. CPA Australia believes this task to be within the remit of the Financial Reporting Council as laid out in section 225 of the *Australian Securities and Investments Commission Act 2001* and further recommends that appropriate additional funding be provided to the AASB to cover this major development.

### **Recommendation:**

CPA Australia recommends the Australian Government, through Treasury, actively pursue developments in integrated reporting, particular given the IIRC's intentions to develop criteria for regional coverage and to present a framework proposal to the G20 November meeting. Further, that appropriate funding be provided to the AASB to pursue this major development in the national interest.

The challenges for disclosure are not confined to the corporate sector and there is compelling evidence suggesting the need for similar transformation in particular aspects of government reporting. CPA Australia would like firstly to address practices around state of the environment (SoE) reporting.

The government's *Intergenerational Report 2010* provides a major platform for assessing the fiscal and economic challenges that Australia will face over the next 40 years. Such challenges are expected to arise in fundamental areas such as population ageing, infrastructure, health and climate change. Significantly, two chapters of the report are devoted to issues of sustainability; Chapter five 'Climate change and the environment' and Chapter six 'A sustainable society'. In the latter of these (at p.86) the following astute remark is made:

"To measure sustainability, indicators are needed that tell us about the qualitative and quantitative changes in the various 'stock' that matter for future wellbeing. The different perspectives people and societies have on wellbeing will result in different assessments as to whether wellbeing has improved over time."

This reference to measurement is presented within the concept that society inherits a stock of capital, including environmental capital, which we bequeath to future generations either depleted, enhanced, or in some other way altered, through our current capabilities and choices. A similar rationale is evident in the integrated reporting framework currently under development.

The absence of well developed and accepted measures of the value of the environment is a universal problem, the redressing of which will focus on the critical attributes of natural asset management in terms of depletion and preservation trade-offs, particular as they operate at an intergenerational level. As an important component in this development, CPA Australia would like to direct attention to the work that has recently been undertaken by the European-based Economics of Ecosystems and Biodiversity (TEEB) project. The ongoing outputs of this project, including TEEB for National and International Policy and Making and their November 2010 *Synthesis* report, we suggest, could form a highly beneficial component in supporting the government SoE reporting under the five-year cycle provided for in section 516B of the *Environment Protection and Biodiversity Conservation Act 1999*.

### **Recommendation:**

CPA Australia recommends that the Department of Sustainability, Environment, Water Population and Communities be provided with short-term funding to investigate the suitability of TEEB as a component in the development of current and future cycles of SoE reporting, and as a basis for assisting related environmental policy development.

Governments can play a significant role by leading by example in terms of their own reporting, which, in turn, dovetails to related activities to promote responsible practices. CPA Australia welcomes the Australian Government's long-standing commitment to lead by example on sustainability. With this commitment, we recommend that the government and its agencies prepare sustainability reports in line with either the G3.1 or G3 Guidelines issued by the GRI. It is noted that the GRI Guidelines will be subject to its next major phase of redevelopment (G4) in 2012. One of the major components of this phase will be an adjustment in response to the development of integrated reporting. These sustainability reports should form part of the annual reports by government agencies to the Parliament of Australia. Over time, government agencies should be preparing integrated reports, incorporating a more complete and comprehensive set of disclosures, including sustainability issues. A significant benefit to the economy of government agencies preparing sustainability reports is that this would, over time, significantly enhance the capacity of the Australian workforce to prepare sustainability reports, and hence integrated reporting, which will eventually benefit the broader business community.

**Recommendation:**

Government agencies should be required to prepare sustainability reports and incorporate such reports in their annual reports to the Parliament of Australia. Such sustainability reports should be prepared in accordance with the current GRI Guidelines.

# Promotion of responsible practices

CAMAC's 2006 analysis of the effectiveness of the various market and principle-based regulatory mechanisms applied to promote responsible practices is prefaced by the following introduction:

## Promotion of responsible practices

*In considering possible further steps to encourage companies to adopt socially and environmentally responsible business practices, this chapter reviews a range of voluntary industry and market initiatives as well as government measures, summarises the views and proposals in submissions and sets out the Advisory Committee's conclusions.*

Here again the GFC has more recently focused attention on the need for governments and businesses to act collaboratively to achieve improved practice and the necessary shift to a more sustainable basis for creating economic prosperity.

Closely preceding the formalisation of the IIRC discussed previously was an announcement of a series of propositions presented at the GRI 2010 Global Conference on Sustainability and Transparency in Amsterdam. The principal proposition concerned the development of integrated reporting and that it be universally applied by 2020. As an interim and related measure it was further proposed that:

“By 2015, all large and medium-sized companies in OECD countries and large emerging economies should be required to report on their ESG performance and, if they do not do so, to explain why.”

Presently in Australia, the nearest medium for this type of narrative disclosure is via the ASX Corporate Governance Council's principles and recommendations, particularly Principle 7 dealing with recognition and management of risk. While expressed as a “proposition”, what is contemplated needs to be considered in a wider context. There have been significant international reviews of governance frameworks (the United Kingdom Financial Reporting Council, the United Kingdom Walker Committee, the South African King Committee and the OECD Steering Group on Corporate Governance) that point to a widening scope of ESG disclosure. Additionally, there have been developments that either drive or support investment community capacity and appetite to handle corporate ESG information as an element in evaluating risk and for the offering of socially responsible investment products or portfolios (the initiative of the Australian Treasury in 2008 to support the Responsible Investment Association Australasia is noteworthy). CPA Australia does not recommend highly

prescriptive regulatory approaches to this type of emerging disclosure practice. Rather, CPA Australia believes that there is significant opportunity for capacity building among corporations to which the government should lend its targeted support.

## Recommendations:

- That the government provide financial support for specific projects that might arise from time-to-time under the umbrella of GRI Focal Point Australia. The Focal Point has, to-date, been funded from a range of sources, including Treasury and CPA Australia, and is a critical plank in promoting awareness and uptake of the GRI Guidelines, which are widely accepted as the de facto global standard for non-financial reporting.
- For the benefit of Australian businesses seeking to respond positively to the trend towards higher quality and more integrated disclosures, there be developed, with government assistance, a GRI National Annex, or similar data gathering, that would assist in mapping the existing array of corporate ESG disclosures as a basis for simpler and more efficient reporting.
- That a combination of sources promote financial support for the ongoing development of the Good Business Register® presently housed at St James Ethics Centre.

A longstanding issue for business centres on a perception, and perhaps even actuality, of an absence of coherence in policy across departments and tiers of government. One avenue by which this may be addressed is adoption of recommendation 1 of the House of Representatives Standing Committee on Environment and Heritage September 2007 report, *Sustainability for Survival: Creating a Climate for Change: Inquiry into a Sustainability Charter*. This recommends that the government, in consultation with key stakeholders, establish a national sustainability commission as a statutory body to set clear sustainability targets for Australia and to monitor Australia's performance against those targets.

**Recommendation:**

The government fund the establishment of a Sustainability Commission to set sustainability targets for Australia and monitor performance against those targets.

CPA Australia also supports the adoption of Recommendation 2 of the same report, namely that the government establish a national sustainability charter.

**Recommendation:**

The government direct the Sustainability Commission to draft a sustainability charter to shape behaviour on sustainability.

