



Australian Centre for Corporate Social Responsibility

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## **ACCSR Occasional Paper 2: Response to Submissions for the ASX CGC Review of the Principles of Good Corporate Governance and Best Practice Recommendations**

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### **Background**

The Australian Securities Exchange Corporate Governance Council (ASX CGC) first released its Principles of Good Corporate Governance and Best Practice Recommendations in March 2003. After two years in application the ASX CGC set out to review the Principles to determine their relevance against the backdrop of the evolving nature of corporate governance. This review began in 2005, with the ASX CGC releasing its consultation paper in November 2006.

The ASX CGC particularly wanted the review to concentrate on the issue of material business “non-financial” risks (referred hereon as Environmental, Social and Governance – ESG – risks). The ASX CGC wanted to garner the opinions of a range of stakeholders on the concept of ESG risks and whether the ASX CGC had a role in providing guidance on CSR/Sustainability reporting. The ASX CGC also wanted to hear if the stakeholders thought Principle 7, under the Principles framework, should be expanded to include additional reporting requirements in relation to these risks (ASX CGC Consultation Paper, 2006).

ACCSR welcomes the review of the Principles and Best Practice Recommendations by the ASX CGC, which followed reviews into the application of regulatory and soft market mechanisms related to corporate social responsibility undertaken by the Parliamentary Joint Commission on Corporations and Financial Services and the Corporations and Markets Advisory Committee. These reviews both asserted there is no legislative impediment to corporate social responsibility and affirmed that the ASX CGC could positively influence corporate approaches to managing social and environmental risk through its principles and best practice recommendations, especially related to Principle 7 disclosures.

ACCSR supports this position contending that it is natural and proper for the ASX CGC to address issues of corporate responsibility and sustainability reporting. ACCSR believes the most effective course for the ASX CGC to take in its current review of Principle 7, related to disclosure of risk, would be to introduce a more stringent “if not, why not?” reporting requirement to facilitate the consistent and effective disclosure of environmental and social risks and opportunities.

### **Disconnect between investment community and listed companies**

One of the most interesting issues to come out of the ASX review was the emerging disconnect between the investment community and listed companies on the disclosure of ESG risks and how these should be reported. Investors and listed companies had very different views on what the proper role for the ASX CGC should be in this area.

### **What listed companies argued**

Submissions from many listed companies tended to favour an approach which would not effect major changes to the ASX CGC’s Principles and Recommendations.

In general, most listed companies who responded to the ASX CGC inquiry, supported by major business representative organisations, such as the Business Council of Australia and the Australian Institute of Company Directors, called for the Principles and Recommendations to remain flexible and discretionary in application. Whilst the “if not, why not” philosophy espoused by the ASX CGC was noted as underpinning a valuable approach to corporate governance, listed companies generally opposed any notion that the Principles should go further. Company submissions called for no additional reporting requirements to be placed upon them - either under the guise of voluntary guidance or as a mandatory requirement. They were also sceptical of any moves for greater disclosure of material business risks.

The reasons cited by companies are:

- The *Corporations Act*, under s.299a, already includes reference to disclosure of material business risks, under which CSR/Sustainability risks and subsequent reporting can be aligned. Many companies already disclose their sustainability performance.
- The measures put forward by the ASX CGC could induce a “tick-box” compliance mentality.
- Companies are diverse and at different stages of their CSR journey and additional reporting requirements at this stage may stifle innovation.
- The ASX CGC has no history or expertise to assist companies in this area.
- For some companies, the costs of implementing a CSR/Sustainability reporting regime would be too high and difficult to resource.
- Adequate information to shareholders and stakeholders may not be provided, because the information may be too imprecise, or full disclosure is not achievable given the dynamic nature of risk management.
- Disclosure of risks may lead to revelations of commercially sensitive information and may open new avenues for litigation.
- The recommendations go beyond the scope of the ASX Corporate Governance Principles because they are too prescriptive. The purpose of the ASX CGC is to issue a flexible framework for corporate governance to provide practical guidance to listed companies. The outputs of the ASX CGC should not be to create a mandatory level of new corporate regulation.

### **What investors argued**

In contrast to corporate positions outlined above, investors saw a greater role for the ASX CGC and its Principles.

In Australia and internationally, members of the investment community are increasingly making the “materiality linkage” between financial value and ESG issues. They are demanding greater levels of disclosure by companies and this information is being incorporated into their financial assessment of companies. They have also been leading innovative initiatives such as the United Nations Principles for Responsible Investment; the Equator Principles; the Enhanced Analytics Initiative; the Carbon Disclosure Project; and the Investor Group on Climate Change. This more engaged, more activist, role of investors in building a broader range of ESG issues into their risk management and lending profiles underscored the position of many submissions by these organisations. Investors tended towards an approach which encouraged the ASX CGC to assume a heightened role in CSR/Sustainability Reporting through the Principles.

The Investment and Financial Services Association (IFSA) says that every listed entity should have in place methodologies to identify, rank and manage every material business risk.

“IFSA members do not distinguish between financial risks and other risks when assessing the value of a company ... Investors now seem more convinced than ever before that how a company goes about identifying, assessing and managing environmental and social issues is central to good corporate governance.” (ASX CGC Submission, IFSA, 2007)

This sentiment is supported by other organisations from the investment community including the Australian Council of Super Investors (ACSI), the Financial Services Institute of Australasia (FINSIA), the Association of Super Funds of Australia (ASFA), the Australian Institute of Superannuation Trustees (AIST) and the BT Governance Advisory Service (BT GAS).

### **The disconnect in positions**

The ASX CGC review has uncovered a clear disconnect in Australia between how listed companies and the investment community view the disclosure of ESG risks and how they should be reported. This disconnect revolves around the issue of corporate transparency and accountability and how this is managed and applied in corporate governance procedures.

Whilst investors wanted more disclosure, listed companies were adverse to it. This may not be surprising. Companies are by nature wary of greater regulation because of increased compliance (resource) burden. What may be surprising was that companies who are leading the CSR field in Australia were the most vocal critics of the proposed ASX CGC changes. Perhaps this is because there is considerable reputational advantage tied to self-initiative. Companies claiming credit to taking action on CSR/sustainability issues could see some of their prestige erode if every listed company was required to meet certain standards.

There may be more to this issue however. The arguments proposed by companies for not endorsing a greater ASX CGC role are not necessarily persuasive when weighted against the espoused advocacy by particular personnel in companies concerning CSR/Sustainability. This opens up the critical question regarding what internal dynamics in companies are driving the variation in perceived sustainability positions and official responses to corporate regulation.

Particularly it raises the question of whether a struggle is emerging in the corporate organisational paradigm between two opposing forces. Just who is driving the CSR agenda within Australian companies?

### **Reactive and Proactive CSR**

In the early stages of CSR, CSR strategy can be reactive – an effort to shore up reputation or the perceived threat of a company's "license to operate".

More recently, CSR aims to align corporate strategic focus to a deeper understanding of the intrinsic role of the corporation in securing long term profits and other rewards for both shareholders and society. For companies, this could be referred to as "proactive CSR" and is where companies use CSR practices to raise capital, sell products or recruit talent. This type of CSR leads to the kind of innovation listed companies say they want to aspire to, but fear the revised draft of the ASX CGC Principles will stifle.

Within listed companies there appears to be a clash between reactive and proactive CSR mindsets. This clash appears to be played out between those in the company with responsibility for CSR and those personnel with financial and risk management functions. The former, like the investment community, are increasingly seeking long-term value which will be delivered through proactive strategies. They see CSR as a strategy that will deliver real long-term value to the company's bottom-line. However, the latter group, the corporate financial and risk management professionals, appear not to have been sold on this idea. This is apparent in the corporate submissions which have opposed ASX CGC disclosure and reporting requirements. The disparity comes down to an understanding of how far CSR should go and what it is good for.

### **Future directions**

The ASX CGC review of Principles presents a key opportunity to highlight the importance of ESG risks to company value, thereby embedding the development of CSR/sustainability in the mindset of corporate Australia. Investors have demonstrated their preference for this to happen. The investment community has declared through their responses to the ASX CGC review, and more broadly through global instruments, that "business as usual" approaches will not deliver the returns shareholders have come to expect in a politico-economic landscape dominated by pressing environmental and social issues.

Companies may contend that any moves towards greater disclosure and reporting are unwarranted. Rather than this being an outcome of fear of heavier compliance burdens however, closer evaluation suggests that it is more an outcome of internal organisational tussles between those personnel pushing a defensive CSR strategy and those pressing a more activist approach.

Ultimately the pull of investors to greater disclosure should see a proactive CSR eventually take root. This would mean that companies and investors alike would be looking to the ASX CGC to play a more interventionist role to ensure transparency and accountability.

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