



**CPA Australia**

**Submission to**

**Corporations and Markets Advisory Committee**

**Discussion Paper**

**Corporate Social Responsibility**

**March 2006**

## EXECUTIVE SUMMARY

CPA Australia believes that it is important to draw a distinction between the legal responsibilities of company directors, their interaction with company stakeholders, and the concept of corporate social responsibility, and that moreover, there is sufficient scope within the law as it currently exists to allow directors to consider stakeholders other than shareholders and it is increasingly common for companies to do so.

The strict notion that companies operate purely in pursuit of profit maximization is a misnomer in both the practicality of modern business, and the legal framework, which affords decision-makers a realistic capacity to make positive allowance for the interests of stakeholders. Directors are obliged to act in the bona-fide interests of the company, however this does not necessarily mean they must always pursue profit maximisation or that they cannot consider the needs of other stakeholders.

The directors' duty is to the ongoing health of the company and must include consideration of the needs of employees, consumers and other stakeholders. Any strategy directed purely at profit maximisation will be realistically tempered by a need to ensure the ongoing viability of the company. On the other hand there needs to be fostered a greater awareness of how changing community expectations can be accommodated within the current framework of directors duties, though without derogating against the essential commercial focus of limited liability.

The introduction of a formalised duty to external stakeholders will upset the cohesion within the evolving structure of the corporations law, create uncertainty and potentially promote undue risk aversion. Directors' primary responsibility must be to the ongoing success of the business and a legitimate component of fulfilling this obligation is to consider all relevant stakeholder interests.

CPA Australia is of the view that some subtle reforms of the Corporations Act are sufficient to address current community concerns – this may occur with respect to both directors' duties and member remedies. Efforts to encourage or prohibit specific social or environmental practices should be addressed through relevant legislation including environmental and labour laws. The corporations law already imposes an obligation on companies to comply with any extraneous laws and this interaction has already compelled improved standards of conduct in environmental protection. Nonetheless, situations of clear abuse of limited liability to evade obligations may warrant more highly targeted response that do not unduly impinge upon the broader business community.

A significant and frequent feature in the corporate social responsibility debate concerns the role of disclosure of non-financial environmental and social performance information as part of communicating corporate responsibility, and as a process for engaging with stakeholders. An absence of well understood methodology in these areas is considered a major impediment to wider adoption of triple bottom line type reporting, and moreover, contributes to a lessening of user confidence in this emergent area of disclosure. CPA Australia's submission points to a number of avenues of development that will contribute over time to the achievement of best practice.

## Chapter 1 The issues of corporate social responsibility

### *How might corporate social responsibility usefully be described for working purposes*

In its recent submission to the Parliamentary Joint Committee on Corporations and Financial Services (PJC), CPA Australia made reference to and commented upon the following two definitions or descriptions<sup>1</sup> of 'corporate social responsibility':

“ - - - behaviour that involves voluntarily sacrificing profits, either by incurring additional costs in the course of the company's production processes, or by making transfers to non-shareholder groups out of the surplus thereby generated, in the belief that such behaviour will have consequences superior to those flowing from a policy of pure profit maximisation”.<sup>2</sup>

and

“the resolution of nearly every issue of corporate social responsibility depends heavily on one's beliefs about how the political process operates and one's convictions about the ideal political process”.<sup>3</sup>

These descriptions are useful alternatives as they focus on the business decision perspectives of risk management and on balancing short and long term viability. Moreover, they highlight the complexity of interrelated factors at play in the corporate social responsibility 'debate'. CPA Australia believes that there is a danger in allowing possibly subjective or extreme views to impact upon the overwhelming positive economic contribution and commercial certainty afforded by the corporation and limited liability. Where there is abuse of the corporate form or a failure to meet evolving community expectations, solutions need to be highly targeted and cognizant of the most appropriate avenue for effecting positive change.

### *Which approach or combination of approaches to responsible corporate behaviour is most appropriate*

CPA Australia in its submission to PJC<sup>4</sup> identified two approaches to building awareness of third-party interests as an adjunct to conducting business in a socially responsible manner:

- empowerment of interest groups, and
- managerial voluntarism directed at greater organisational 'openness'.

As noted in our response generally in Chapter 3, and specifically in relation to question 5 herein, notions of interest group empowerment are problematic. In contrast, *managerial voluntarism* when viewed from the perspective of the emerging utility of non-financial information presents, in CPA Australia's view, a significant avenue for incremental development in both stakeholder engagement and management sympathy for the environmental and social dimensions of business. Development can thus occur, without adversely impacting upon the established and well defined reach of corporate law.

As Parkinson observes:

“ - - - the mere fact of being under a duty to disclose information is not in itself a reason for companies to change their behaviour.”<sup>5</sup>

<sup>1</sup> CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 11-12.

<sup>2</sup> J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) pp 260-262.

<sup>3</sup> D.L. Engel, "An Approach to Corporate Social Responsibility" (1980) 32 *Stanford Law Review* 1.

<sup>4</sup> CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 31-32.

<sup>5</sup> J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) p 372.

The suggested reorientation in the discussion of 'Triple-bottom-line' reporting away from an overwhelming emphasis on external reporting to that of an understanding of the management and utilization of inward flows of information, potentially generates more enduring benefits through:

- an increased capacity for compliance with substantive environmental and social laws,
- motivating the establishment and scrutiny of risk management systems, and
- encouraging responsiveness to the impact of business on the physical and social environment.

As such, 'Triple-bottom-line' reporting would flow as a consequence of continuously improving and adaptive management practices rather than as an end in itself.

*What are the incentives or disincentives for a company to conduct its business in a socially responsible manner*

In its submission to the PJC, CPA Australia expressed the view that a profit imperative and conducting business in a socially responsible manner are by no means mutually exclusive, it clearly demonstrable on a number of fronts that the adoption of innovative and sustainable practices can generate competitive advantage.<sup>6</sup> Those companies that are capable of demonstrating a capacity to manage environmental risk, may likewise be able to command a premium based on this capacity.

Similarly, an increasingly educated and informed consumer market, potentially assisted by emerging levels of voluntary non-financial disclosure, can through its choices act as a source of informal licence by which business survival is dictated.<sup>7</sup> In these terms, those business with an ethos towards continuous adaptability will more likely be the ones that prosper.

Conversely, the present thrust and structure of the Corporations Act, and the wider legal framework within which business regulation operates, cannot be regarded as either an impediment or a disincentive to business being conducted in a socially responsible manner.

The development of incentives which negate the negative environmental or social impact of the conduct of commercial activities within liberal democracies such as Australia, demands consideration of a wide spectrum of policy settings extending beyond corporate law. Aside from an understanding of the limitations of corporate law in contrast to more substantive environmental and social public law, regard needs to be given to wider policy considerations. This should occur in such domains as determining the scope for the taxation system to alternatively penalise or promote environmental and social interests, and the manner in which choices are made in relation to infrastructure renewal, to name just a few.

Equally, resolving such concerns involves both an understanding of the interactions of various market forces and identifying the means by which the attitudes of the wider community might be shaped towards more socially responsible outcomes. To suggest that the problems which beset our environment and society are primarily a consequence of rapacious corporate behaviour clearly overlooks the expectations as to what are acceptable levels and types of consumption. The behaviour of many corporations merely

<sup>6</sup> CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 14-15.

<sup>7</sup> CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, p 18.

mirrors societal expectations as to the scale and type of consumption that has come to be expected.

*Do different or additional implications arise depending on the nature or size of the enterprise, for instance:*

- *the sector or industry in which an organisation operates*
- *whether a company has international operations*

There is compelling logic in the idea that corporate social responsibility should be an enterprise size neutral concept – the driving factor being the nature of the undertaking and its environmental and social reach. Whilst disclosure is a vital avenue for communicating environmental and social performance, and therefore engagement with stakeholders, the impact of mandating additional reporting requirements on smaller entities needs to be well understood before a particular solution is advanced through public policy.

Specific reference to cross-border operations may be appropriate to deal with circumstances where the choice of location of corporate operations or assets might be motivated by a specific jurisdiction's lesser environmental, labour or further social laws, or additionally, driven by a desire to protect assets from the reach of regulators or claimants arising out of a breach of an environmental law or civil wrong.

*In practice:*

- *to what extent is corporate decision-making driven by stakeholder concerns*
- *how do companies differentiate between various categories of stakeholders*
- *in what ways do companies balance or prioritise competing stakeholder interests, and*
- *how do companies engage with stakeholders*

*To what extent is corporate decision-making driven by stakeholder concerns*

Both theory and practice overwhelmingly support a commercial rather than a stakeholder concern objective in corporate decision-making. This position is acknowledged without necessarily inferring a position of extreme member primacy that would be manifest in short-term profit or member wealth maximization.

The formation of a company is clearly predicated upon the capacity to avail of limited liability through which participation in an enterprise is ensured through certainty as to the extent of exposure to liability.<sup>8</sup> As the authors of Ford's state in their introductory discussion:

"The privilege of limited liability achievable by formation of a company is not a fundamental human right. It is a franchise given by society to save members from having to seek limitation of liability by more cumbersome methods."<sup>9</sup>

As indicated in our submission to PJC,<sup>10</sup> the granting of the concession of limited liability facilitates private behaviour within bounds of an understanding that it is necessary to maintain a threat of constraint within the law. To regard corporate decision-making as driven by stakeholder concerns, would draw director and management attention away from the interests of those persons for whom the privilege of limited liability is granted, and

<sup>8</sup> It is acknowledged that limited liability may in more extreme circumstances offer a 'perverse incentive' by which there is enabled excessive risk taking, avoidance of emergent liability or the sheltering of assets from legitimate claim. The nature of this abuse warrant highly targeted legislative, and possibly judicial, responses as foreshadowed in the Committee's separate inquiry into long-tail personal injury claims.

<sup>9</sup> Ford, Austin and Ramsay, *Ford's Principles of Corporations Law* (11<sup>th</sup> ed., Butterworths, 2003) [1.080].

<sup>10</sup> CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, p 26.

correspondingly, create an undesirable degree of indeterminacy around the types of actions which would attract constraint.

From an alternative perspective, the company can be viewed as being established as a legal arrangement by which a collective, though fluctuating, fund is applied to predominantly commercial purposes. Notwithstanding the removal of the statutory requirement for an objects clause in the corporate constitution, the vast majority of companies are established for a presumed commercial purpose. Any significant reorientation of corporate decision-making towards being driven by stakeholder concerns, may risk depleting the 'corporate fund' potentially to the point of jeopardising creditor claims.

Nonetheless, as will be elaborated upon, a disregard for stakeholder interests will clearly be detrimental to longer-term commercial viability and potentially expose the corporation to the type of risk that would attract severe sanction under a range of laws external to corporate law.

*How do companies differentiate between various categories of stakeholders, in what ways do companies balance or prioritise competing stakeholder interests, and how do companies engage with stakeholders.*

Two contrasting approaches may be suggested in relation to both the differentiation/identification of, and the engagement of companies, with stakeholders. First, as described elsewhere, there is assumed a significant, though emerging, role of non-financial disclosure<sup>11</sup> which can provide a rigorous and comprehensive description of the quantitative and qualitative performance of business in environmental and social dimensions. Such information can, as with more formalised financial reporting, be regarded as a free 'public good'. Through these developments, a broadening body of stakeholders may be empowered to make their own assessments as to the conduct of a specific company or industry, through which, in turn, a basis of reasoned dialogue may emerge.

Secondly, and more specifically, it is acknowledged that there is an increased trend, particularly observable amongst companies in the extractive industries, where engagement with the community is seen as a vital part of managing the full scope of complex projects. Such instances of 'enlightened self-interest' being highly specific to a company's unique circumstances, do not lend themselves as a basis of broader prescription of corporate conduct. Developments in the direction of organisational openness, are rather, the consequence evolving attitudes that can be encouraged but not compelled.

*In practice, to what extent do stakeholders consider a company's social responsibility performance when making assessments or decisions about a company*

CPA Australia has sought to address these issues by way of conducting in September 2005 a survey of consumer confidence in corporate reporting focusing specifically on issues of attitude and expectation around corporate responsibility. A copy of the research results are enclosed.

A wide range of questions were canvassed amongst a cross-section of users and preparers of corporate disclosure information, and the wider public. Included were

---

<sup>11</sup> See generally CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 33-34.

questions which sought to determine decision-sensitivity to company respective environmental and social reputation.

Significantly, both the 'Shareholder' and 'Directors / CEOs / CFOs' categories in response to questions about their investment decisions expressed the view that they would be significantly discouraged by unfavourable reputation, with greater weight being given to environmental performance over that of aspects of social reputation. In turn, product and service purchase decisions seem significantly less subject to concerns about a company's environmental and social reputation.

In terms of comparison with other categories within the research sample, the preferences of shareholders reflects to a reasonable degree the sentiments of those of the wider general public, whereas the category of 'Analysts, Advisors & Brokers' showed lesser sensitivity to these issues.

On the basis of these responses, it is reasonable to conjecture the presence of a relative degree of congruence of views between directors and shareholders as to the importance of corporate environmental performance. Moreover, the views of directors are not dramatically divergent from public expectations. Elsewhere in the research there is however evidence of divergence of view, particularly around such matters as to whether reporting on environmental and social practices should be mandated.

*Are there any changes that could enhance triple bottom line reporting, sustainability or like reporting, including:*

- increasing the level of clarity and comparability of these reports*
- any suggested changes to external verification of those reports*
- whether any aspect of this reporting should be mandated and, if so, for what companies and in what respect(s)*
- are there particular issues for small to medium enterprises*

These issues are considered at length in our submission to PJC<sup>12</sup> in which there is described the rationale of a major research project being undertaken by the University of Sydney and CPA Australia under the auspices of the Australian Research Council.

Briefly, the project involving academics from the disciplines of accounting, physics and communications, addresses by way of applied field studies, the integration of sustainability and accounting information that will enable significantly improved internal accumulation, measurement and analysis/assimilation of environmental and social data. An absence of well understood methodology in these areas is considered a major impediment to wider adoption of triple bottom line type reporting, and moreover, contributes to a lessening of user confidence in this emergent area of disclosure. Difficulties in this regard may be particularly pronounced for small-to-medium size enterprises who are less able to marshal the necessary resources to embark upon non-financial reporting.

It is further anticipated that improved outcomes will be facilitated through the flow and utility of information for decision-making which is essential to improve performance and risk management in these domains. Improvement in the quality and utility of non-financial disclosure, and the opportunity for wider take-up, will thus flow as a direct consequence of this more integrated approach. Nonetheless, development in this direction should be allowed to emerge over time, rather than pursuing 'quick fix' mandated prescriptive

---

<sup>12</sup> CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 33-37.

approaches which potentially fail to capture firm specific characteristic and which would likely attract an attitude toward minimum compliance.

Noteworthy also is the extent to which enhancement of non-financial data management will be highly complementary to enabling appropriate standards and levels of assurance of sustainability and triple-bottom-line reporting. The current form of Australian guidance is described in recently released CPA Australia / University of Sydney research<sup>13</sup>:

“In June 2003, the Audit and Assurance Standards Board (AuASB) issued AUS 110: *Assurance Engagements other than Audits or Reviews of Historical Financial Information*. This standard establishes basic principles and standards to be applied by auditors when completing work such as verification of sustainability reports. - -  
- It should be noted that AUS 110 does not call for audit of non-financial information, but prescribes principles that should be followed in the event that such an audit or review is undertaken.”

Research conducted by the University of Sydney on behalf of CPA Australia highlighted within the limited take-up of triple-bottom-line reporting, relatively fragmented approaches to the application of external assurance and verification.

CPA Australia would further like to draw the Committee’s attention to work currently being undertaken by the International Audit and Assurance Board (IAASB) of the International Federation of Accountants (IFAC) in relation to assurance issues arising out of the release for public comment by the Global Reporting Initiative (GRI) of its version three of Guidelines.

---

<sup>13</sup> [http://www.cpaaustralia.com.au/cps/rde/xbcr/SID-3F57FEDF-69D42C6A/cpa/sustainability\\_reporting\\_asia\\_pacific.pdf](http://www.cpaaustralia.com.au/cps/rde/xbcr/SID-3F57FEDF-69D42C6A/cpa/sustainability_reporting_asia_pacific.pdf)

## Chapter 2 Directors' duties: current position

*Whether and in what circumstances, companies feel constrained by their understanding of the current law of directors' duties in taking into account the interests of particular groups who may be affected, or broader community considerations, when making corporate decisions*

Consistent with the notion of proximity, directors' duties of care and diligence are regarded as being owed to their companies<sup>14</sup> on the basis of relationship and obligation. Similarly, the analogy of a fiduciary is applied to ensure loyalty of directors to act for the benefit of the company, and by inference shareholders.<sup>15</sup> Nonetheless, focusing management attention on the "continued health of the corporation" should allow reasoned regard for a wider constituency of interest affected by the companies' activities.<sup>16</sup>

Directors duties have evolved to regularise the company / member / director relationship within the bounds of limited liability and separate corporate legal personality. The wider community does however derive a benefit by way of an assured level of integrity in the conduct of corporate affairs.<sup>17</sup>

This description of the scope and limitations of corporate law provides a significant indication of the proper demarcation between particular branches of the law and the objectives to which they are put. Advancement of environmental and community interests are best pursued by targeted legislation to which corporations, along with all citizens, are subject.<sup>18</sup>

Those instances where the corporate form itself might be regarded as a source of 'perverse incentive' by which regard for a legitimate interest is evaded, such as those of long-tail tort claimants, should attract highly targeted forms of intervention which do not adversely impact upon the wider business community.<sup>19</sup>

It is acknowledged that there is criticism<sup>20</sup> of the corporate law / environmental law 'dichotomy' as functioning within a presumed development paradigm in which environmental concerns are balanced against overarching economic development imperative. However as previously noted, any suggestion of a departure from the economic premise of incorporation and limited liability presents far reaching implications. CPA Australia respectively suggests that such deliberations would need to take place in a forum wider than the Committee's current scope, in which the possible trade-off of living standards and the community's preferences could be more comprehensively explored.

<sup>14</sup> CPA Australia submission to CAMAC Review of Corporate Duties Below Board Level, September 2005, p 14.

<sup>15</sup> M. Whincop, "Overcoming Corporate Law: Instrumentalism, Pragmatism and the Separate Legal Entity Concept" (1997) 15 *Company & Securities Law Journal* 411 at p 422.

<sup>16</sup> CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 20-21.

<sup>17</sup> *Darvall v North Sydney Brick & Tile Co Ltd & Ors* (1989) 15 ACLR 230 at 231 per Kirby P.

<sup>18</sup> CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, p 21 and p 26.

<sup>19</sup> In this regard, CPA Australia notes CAMAC's call for submissions in response to a Ministerial referral in relation to the treatment of future unascertained personal injury claims.

<sup>20</sup> See Bielefeld, Higginson, Jackson and Ricketts, "Directors duties to the company and minority shareholder environmental activism" (2004) 23 *Company & Securities Law Journal* 28 at p 30.

*If so, is there any useful scope for clarifying the current law in this respect*

The Corporations Act<sup>21</sup> presently provides in relation to directors' business judgements a 'safe harbour' protection from judicial scrutiny and shareholder challenge. This protection relates directly to decisions within the ambit of the duty of care and diligence. Given the scope for directors to have regard for a wider constituency affected by their decisions, CPA Australia suggests that certainty in the law and encouragement of good corporate conduct could be achieved by extending this type of protection to decisions within the loyalty obligations of good faith and acting in the best interests of the corporation.<sup>22</sup>

*Does the current law give directors sufficient flexibility to balance long-term and short-term considerations in their decision-making*

Within the often quoted notion that "directors must act bona fide for the benefit of the company as a whole"<sup>23</sup> there is clear scope for balancing short and long-term considerations within an understanding of member interests; present and future. Similarly the duty being owed to the company as a distinct entity likewise supports a balancing of the short and long-term.<sup>24</sup>

The adaptation of fiduciary obligations is capable of accommodating evolving expectations of the function of the company within society and the presumptions of the strictness of shareholder primacy: "a classic theory that once was unchallenged must yield to the facts of modern life".<sup>25</sup> Nonetheless, it is again emphasised that this concept, though dynamic and reflective of changing realities, still fulfils the primary function of protecting shareholders who are vulnerable to managerial opportunism. Thus any development in the law of directors' duties towards a formalised recognition of non-shareholder stakeholder interests, potentially creates uncertainty in the conduct of a corporation's affairs.

*Are any changes needed to the current law regarding the rights of shareholders to express their view by resolution at general meetings on matters of environmental or social concern?*

The capacity of shareholders to express their views by way of resolution is provided for in Division 4<sup>26</sup> of Part 2G.2<sup>27</sup> of the Corporations Act with the key operative section being s 249N (Members' resolutions). The authors of Ford's in commenting on this section note that members may not use the powers to requisition a meeting and demand a motion to be put where, "the subject is a matter of management exclusively vested in the directors".<sup>28</sup> Any change from this established position, CPA Australia believes, would only be tenable as part of a substantive shift in the division of corporate powers, for which the current Inquiries or elsewhere present no compelling evidence.

<sup>21</sup> Section 180(2)

<sup>22</sup> CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 23-24. It should further be noted this form of protection should more than likely not extend to the 'proper purpose' second limb of s 181(1) given the more specific types of powers covered.

<sup>23</sup> *Mills v Mills* (1938) 60 CLR 150 at 188 per Dixon J.

<sup>24</sup> CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 16-19.

<sup>25</sup> *Teck Corporation Ltd v Millar* (1973) 33 DLR (3d) 288 at 313-314 per Berger J.

<sup>26</sup> Members' rights to put resolutions etc. at general meetings

<sup>27</sup> Meetings of members of companies

<sup>28</sup> Ford, Austin and Ramsay, *Ford's Principles of Corporations Law* (11<sup>th</sup> ed., Butterworths, 2003) [7.123]. The authors cite with approval the authority of McLelland J in *NRMA Ltd v Parker* (1986) 6 NSWLR 517, stating "on balance, McLelland J's approach should be supported".

Ancillary to the powers granted to members in general meeting, is the law of member remedies.<sup>29</sup> Here CPA Australia suggests<sup>30</sup> that there is room for cautious development to enable members to make enquiry about their companies' compliance and risk management procedures in relation to substantive environmental, social and civil wrongs laws. Conversely, an understanding of the scope of these members' remedies operating in parallel with the powers of the courts to grant relief,<sup>31</sup> should provide protection from unreasonable challenge by members where a decision on a matter of environmental or social concern is arrived at honestly.

---

<sup>29</sup> Corporation Act 2001 Part 2F.1 Oppressive conduct of affairs

<sup>30</sup> CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 24-25.

<sup>31</sup> Corporations Act s 1318 Powers to grant relief

### Chapter 3 Directors' duties: matters for consideration

*Should the Corporations Act be revised to clarify the extent to which directors may take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?*

CPA Australia believes that the possibly prescriptive and more highly rule-based approach alluded to in this question may in fact operate against the flexibility described in our response to question 3 of Chapter 2. Directors are able to identify emergent stakeholder interests as part of safeguarding long-term commercial viability. To state that directors "may take into account" does not necessarily translate into positive action. Positive development in this direction will emerge more effectively from an enlightening of attitude which, in turn, is likely to arise as a consequence of education and leadership. Nonetheless, to reiterate the point previously made, the law should be amended to clarify the protection of directors making such stakeholder based initiatives where determined in the overall long term interests of the company.

*Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?*

CPA Australia rejects development in the Corporations Act in the manner suggested.

Presently the Corporations Act does not specifically recognise particular classes of shareholder. Thus to introduce into corporate law the notion of classes of stakeholder for which there is not an established basis of legal obligation, would suffer problems of indeterminacy.

CPA Australia in its 2005 Confidence in Corporate Reporting survey, canvassed the views of a cross-section of business professionals, shareholders and the wider public who ranked shareholders and employees as the primary categories of stakeholder. The next most clearly recognised categories of stakeholders were creditors and the local environment, with customers, the local community and future generations ranking further behind. The interests of a number of these categories of stakeholder are precisely defined by contract, and particularly with respect to employees, more targeted provision is made to address specific vulnerability arising from corporate insolvency. Similarly the Act's insolvent trading provisions<sup>32</sup> affords to unsecured creditors an appropriate degree of protection without creating a more formalised duty within directors' general duties; the impediments to which are identified in our response to the PJC.<sup>33</sup>

The remaining interests of the environment and community, though comparatively nebulous, are nonetheless protected in the manner described in our response to Chapter 2 by means of effective and vigorously applied public laws having their own structure of appropriate of sanctions and remedies. Additionally, the imprecise and possible shifting nature of these interests, are moreover, best addressed from the company's perspective via voluntary engagement potentially fostered by improved practices in non-mandatory disclosure.

<sup>32</sup> Part 5.7B – Division 3 – Director's duty to prevent insolvent trading

<sup>33</sup> CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 16-17.

*Does the Corporations Act need to be amended to adopt a pluralist, an elaborated shareholder benefit, or some other, approach to directors' duties*

CPA Australia suggest that a worthwhile understanding of the issues raised in this question can be gained from the perspective of the internal management of the company, and how in turn, these rules relate to the exercise / division of corporate powers.

Consistent with the notion of the corporation as an association of individuals who come together for commercial gain protected by limited liability, the corporate constitution (and replaceable rules) which regulates the internal dealings of the company, functions as a contract between the company and its members, amongst the members and between company and its directors; though significantly not between the directors and members.<sup>34</sup> Both statute<sup>35</sup> and case law<sup>36</sup> establish that the responsibility for management of the company rests with the directors.

The structure of directors' duties contained in Part 2D.1 thus, to a large degree, functions to align the behaviour of director with the interests of the members, who upon forming or joining the company, are unable contract with directors to ensure full congruence of behaviours.

It is CPA Australia's view that this vital cohesion which has emerged over time within the wider scheme of the corporate law, would likely be damaged were it sought to be adapted to safeguard of the interests of other stakeholders.

*Would any suggested change be intended to go beyond the current law or would it be intended as a clarification only*

Again, CPA Australia would like to reiterate that changes to the substantive law are not warranted, thus any amendment should be directed at clarifying what is already supported by, or pointed to, in the present understanding of the statute and associated case law. On this latter point, we would like to draw attention to the operation of s 185<sup>37</sup> which gives equal footing to general law rules in the treatment of directors' duties.<sup>38</sup> As such, this section provides a vital means by which the law of directors' duties can evolve through case law development to reflect changing needs and expectations.

This capacity for change is clearly identifiable in the development in the evolving judicial understanding of the duty of care and diligence.<sup>39</sup>

---

<sup>34</sup> Section 140

<sup>35</sup> Section 198A

<sup>36</sup> *John Shaw & Sons (Salford) Ltd v Shaw* (1935) 2 KB 113 at 134 per Greer LJ. See CPA Australia submission to CAMAC Review of Corporate Duties Below Board Level, September 2005, pp 5-6.

<sup>37</sup> Interaction of sections 180 to 184 with other laws etc.

<sup>38</sup> See CPA Australia submission to CAMAC Review of Corporate Duties Below Board Level, September 2005, p 4.

<sup>39</sup> See for example *Daniels & Ors v Anderson & Ors* (1995) 16 ASCR 607 at 661 "neither the law about the duty of directors nor the law of negligence has stood" per Clarke and Sheller JJA, and further quoting Tadgell J in *Commonwealth Bank of Australia v Friedrich* (1991) 5 ASCR 115 at 126: "As the complexity of commerce has gradually intensified - - - **the community has of necessity come to expect more** than formerly from directors whose task it is to govern the affairs of companies". (Our emphasis)

*If a pluralist approach were adopted:*

- *should directors be permitted to take into account the interests of specific classes of stakeholders or the community when making corporate decisions, or alternatively*
- *should the directors be required to take into account the interests of specific classes of stakeholder or the community when making corporate decisions*
- *in either case, what broader interests should be identified*
- *how might any proposed amendment be implemented and enforced?*

CPA Australia is of the view<sup>40</sup> that there exists valid political and economic barriers to the adoption of a 'pluralist' approach, along with further even more radical views such as the 'corporation as community'.

As an alternative perspective, again referring to the work of Parkinson:

"It is quite possible that the arrangement [that companies exist to make profits for the benefit of shareholders] is the one that is most conducive to the public good. But the point is that making profits for shareholders must now be seen as a mechanism for promoting the public interest, and not as an end in itself."<sup>41</sup>

This notion of the corporation as a 'social enterprise', CPA Australia suggests, might form a better basis for identifying approaches to balance legitimate public interest, whilst recognising the profit motive and the essential proprietary nature of shareholder participation which underpins much of Australia's economic activity.

Again reiterating comments made elsewhere, what is required is a balanced approach focusing on education and a changing of attitude amongst directors, shareholders and the wider community, whilst at the same time ensuring the essential commercial orientation of the corporation.

*If an elaborated shareholder value benefit approach were to be adopted:*

- *what form should it take*
- *would the UK Company Law Reform Bill clause be an appropriate precedent, either as drafted or with amendments*
- *how might any proposed amendment be implemented and enforced?*

Whilst acknowledging merit in the concept of 'enlightened shareholder value', CPA Australia suggests that the cautious approach to the development of directors' duties described in our response to Chapter 2 questions, offers more targeted and certain outcomes, whilst at the same time presenting avenues for ongoing development that reflects incremental shifts in community expectations. Again, it is emphasised that there should not be underestimated the capacity of case law as a parallel source for guiding appropriate development in the law of directors' duties.

The UK development does not seem in any way to suggest the creation of an actionable right for non-shareholder stakeholders, and importantly, reiterates the unique position of unsecured creditors in circumstances of impending insolvency. Nonetheless, there should be acknowledged the current appropriate balance of considerations contained within Australia's present laws of member remedies and meetings of members.

<sup>40</sup> CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, p 25.

<sup>41</sup> J.E. Parkinson, *Corporate Power and Responsibility* (Clarendon Press. Oxford 1993) p 23.

## Chapter 4 Corporate Reporting

*Are any changes to current statutory requirements needed to ensure better disclosure of the environmental and social impact of corporate activities*

Aside from any specific reporting requirements contained in environmental, labour or wider social oriented public laws, the most direct disclosure requirement relevant to corporations is that contained in s 299(1)(f) of the Corporations Act - the provision requiring directors to report on performance in relation to significant environmental regulation. Given the inclusion of this requirement within the *Annual financial reports and directors' reports*<sup>42</sup> provisions, consideration of possible enhancement or strengthening needs to be considered in the wider context of emergent regulation and evolving practice in this area.

The authors of Ford's<sup>43</sup> express the view that the requirements of s 299 can be met in a "relatively constrained fashion" falling somewhat short of the more discursive requirements contained in 'management and discussion analysis' as adopted in some overseas jurisdictions. Nonetheless, the introduction of s 299A<sup>44</sup> as part of the CLERP 9 Act 2004, along with authoritative comments,<sup>45</sup> indicate a clear trend towards greater rigor in the preparation of such disclosures and the adoption of a MD&A 'philosophy', though significantly without pursuing highly prescriptive or mandated approaches.

In addressing the further development or enhancement of s 299(1)(f) in this context, CPA Australia suggests that there is scope for implementing best practice guidance specific to this section, developed perhaps in cooperation between ASIC, the ASX Corporate Governance Council, the Department of the Environment and Heritage, and the professions. As a source of guidance, this may loosely be drawn from the experience gained in developing ASIC's s 1013DA<sup>46</sup> disclosure guidelines<sup>47</sup> and the work undertaken by DEH in relation to departmental and agency reporting under the Environment and Biodiversity Conservation Act 1999.<sup>48</sup> Significantly, the adoption of a principle based approach such as this, would enable refinement over time as preparers gain greater experience in the practicalities of such reporting.

*Are any changes desirable to any other reporting requirements, such as the ASX Listing Rules requirements, the ASX Corporate Governance Principles or the relevant accounting standards, to provide more relevant NFI to the market*

As with the thrust of our response to question 1 above, CPA Australia believes that the current structure of rules presents an appropriate framework within which practice may develop, with the assistance of targeted guidance, to meet emergent expectation and needs in relation to the disclosure of corporate environmental and social performance. To this end, CPA Australia acknowledges and broadly commends the current initiatives of the ASX Corporate Governance Council in its review of the applicability of Principle 7<sup>49</sup> of its

<sup>42</sup> Division 1 of Part 2M.3 Financial Reporting

<sup>43</sup> Ford, Austin and Ramsay, *Ford's Principles of Corporations Law* (Lexis-Nexus Online ) [10.230].

<sup>44</sup> Annual Directors' Report – additional general requirements for listed public companies

<sup>45</sup> The authors of Ford's make reference in particular to the G100 and the recommendations of the HIH Royal Commission.

<sup>46</sup> Information about ethical considerations etc., Pt 7.9 – Div 2 – product Disclosure Statements of Chapter 7 Financial Services and Markets

<sup>47</sup> "ASIC guidelines to product issuers for disclosure about labour standards or environmental, social and ethical considerations in Product Disclosure Statements (DPS)"

<sup>48</sup> section 516A Annual report to deal with environmental matters

<sup>49</sup> Recognising and managing risk

Principles of Corporate Governance and Best Practice Recommendations to the description of sustainability and corporate responsibility risk.

*In relation to any proposed further reporting requirements, should desired information be in a narrative or quantitative form*

It is CPA Australia's view that where possible information on the environmental and social performance of companies should be quantitative as this reduces subjectivity, aids comparison of performance over time and on a cross-sectional basis between companies, and moreover, enhances the scope for independent assurance. Noteworthy towards this end, is the inclusion of a wider and more comprehensive range of metrics within the latest draft version of the GRI. Nonetheless, particular dimensions of performance are best captured and encapsulated in narrative comment – here again the focus of the type of guidance development describe above should be on an understanding of user utility and comprehension.

*Is it possible to specify criteria to assist in comparing narrative disclosures, including by valuing or quantifying intangibles*

Aside from the comments made elsewhere in relation to this Chapter of the Committee's discussion paper, CPA Australia would like to stress that consideration of the aspect of measurement raised by this question needs to be cognizant of the existing framework and details of accounting standards, which as legislative instruments, should prevail.

*Would an additional environmental or social 'impact' reporting obligation be appropriate and feasible and, if so, how might it be stated?*

Referring to our response to question 1 above, it is CPA Australia's view that the present reporting requirements contained in corporate law, assisted by the cooperative development of appropriate guidance, present a sound framework within which environmental and social reporting may evolve. This coupled with the building of internal non-financial information collection and assimilation capabilities,<sup>50</sup> and the emergence of frameworks such as the GRI, thus precludes for the present time the necessity for additional 'layers' of reporting obligations.

At a more applied level, CPA Australia suggests that a further avenue of required development that will emerge over time, is in the realm of practices and methodologies which assist preparers of sustainability reports to identify and measure their reporting boundary in terms of supply chain and full life-cycle impacts ("sustainability footprint").

---

<sup>50</sup> Refer our response to Chapter 1.

## Chapter 5 Encouraging responsible business practices

*To what extent are voluntary initiatives leading to improvements in corporate social and environmental performance*

Consistent with the themes developed in our responses to Chapter 4, and moreover generally elsewhere in our submission, CPA Australia believes that advancement of corporate social responsibility requires a balanced understanding of the interaction of various regulatory settings and the importance of cooperatively developed guidances which underpin voluntary practices.

In this regard we would like to reiterate a key substantive issue raised in our submission to PJC<sup>51</sup> concerning the nature of 'command and control' regulation and its suitability to corporate social responsibility. As with other branches of the law, there is an undisputable requirement for strong and certain corporate legislation, complemented by general law principles, which address errant behaviour whilst adding certainty to the conduct of corporate affairs. Nonetheless, given the comparatively imprecise and possibly shifting nature of corporate social responsibility, highly legalistic rule based approaches will not of themselves create willingness towards openness and engagement, and may in fact encourage amongst some an attitude of minimum compliance, or at worst, evasion.

Similarly, it must be understood that the significant cost involved in any shift towards mandating higher orders of non-financial disclosure will be borne by preparers, and that as such, there needs to be considered the context of an understanding of the decision utility of such information amongst users.

*What lessons might be derived from any experience with voluntary initiatives*

Refer above response.

*What would be the nature of any proposed initiatives, what would be its intended purpose and consequences, how might it be implemented and what would be its costs and other implications?*

As a concluding comment, CPA Australia would like to point to its recent research on Regulatory and Professional Initiatives across the Asia Pacific. This research was motivated by a desire to gain an understanding of governance practice and environmental performance reporting reforms implemented broadly in response to the East-Asia debt crisis of 1998. The findings compiled by the University of Sydney show a significant degree of diversity, if not fragmentation and inconsistency, amongst the regional economies. Given the point made in our response to question 4 of chapter 1 that development of sustainable and responsible business practices need to be cognisant of the regional and global impact of corporate behaviour, CPA Australia tentatively suggests that there may be a role for the Australian Government to encourage development and appropriate levels of harmonisation of these practices.

---

<sup>51</sup> CPA Australia submission to PJCCFS Corporate Responsibility Inquiry, October 2005, pp 30-32.