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Ms Mavis Tan ASX Limited 20 Bridge Street Sydney NSW 2000

By email: mavis.tan@asx.com.au

Dear Ms Tan

RE: Net Balance submission –

Proposed changes to Corporate Governance Principles and Recommendations

#### 1. Introduction

Net Balance would like to commend the Australian Stock Exchange (ASX) Corporate Governance Council on its proposal to update and issue a third edition of its Corporate Governance Principles and Recommendations. We also commend the ASX for its proposed changes to its Listing Rules and Guidance Note 9 Disclosure of Corporate Governance Practices, intended to complement and give effect to the changes proposed in the third edition of the Corporate Governance Principles and Recommendations.

This submission responds to the consultation papers issued by both the ASX Corporate Governance Council and the ASX.

Our key area of focus in this submission is to support the implementation of Recommendation 7.4 regarding the requirement to disclose economic, environmental and social risk. Net Balance is well placed to comment on Recommendation 7.4 because of our significant experience and expertise in assisting many of Australia's largest companies to identify, mitigate and manage material economic, environmental and social risk. We also work with companies to advise them on reporting these risks and engaging their stakeholders in this process.

#### 2. About Net Balance

#### 2.1 Overview

Net Balance is Australia's largest and most significant provider of advice, assurance and research across the sustainability value chain. We have offices in Melbourne, Sydney, Brisbane, Perth, Hobart and London and a team of over sixty specialists.



We work with the majority of the ASX 100, a large number of private firms, SMEs, government and industry associations. Our areas of expertise include:

- sustainability strategy and the identification of key social, environmental and economic risks and opportunities
- sustainability reporting and assurance
- stakeholder engagement
- community investment and social impact
- climate change mitigation and adaptation
- energy efficiency
- economics and policy
- environmental management
- supply chain policy and practice

In each of these areas we combine strategic advice with rigorous technical capabilities.

The company also supports the Net Balance Foundation, a parallel not-for-profit that draws on the expertise of our employees to maximise the impact of our work. Up to 20 per cent of employee time is devoted to the Foundation, providing affordable services to not-for-profit organisations and bringing the firm's thought leadership to life through research, events and training.

Net Balance is also a certified B Corporation, joining a growing worldwide group of companies who are voluntarily meeting higher standards of transparency, accountability, and performance across economic, environmental and social impacts. Our work through the Foundation has been key to our certification as a B Corporation.

We also house Tomorrow Agenda Research Institute (TARI). Its focus is on developing quality academic research to help shape strategy, policy, programs and action for businesses, not-for-profit organisations, social entities and government in relation to the creation of social, environmental and economic value.

### 2.2 Our experience in social, environmental and economic risk

Sustainability is based on the platform of identifying and managing social, environmental and economic risk and opportunity, and being transparent with stakeholders as to how you are managing these aspects.

Net Balance provides sustainability advisory and assurance services to some of Australia's largest organisations and most respected brands. We assist them to identify their key sustainability risks, develop strategy to mitigate and manage these risks, provide advice on how to disclosure these risks to stakeholders, prepare sustainability reports detailing the risks and assuring sustainability reports to ensure they are accurate, transparent and address the key issues.



Net Balance employees are active in sustainability research and thought leadership. They sit on committees involved in the development of global reporting standards and frameworks including the Global Reporting Initiative (GRI).

Net Balance Director, Robyn Leeson is recognised as a leader in sustainability reporting. She is a member of the GRI's Stakeholder Council, the GRIs formal stakeholder policy forum, and is also a member of the GRI's Technical Advisory Committee. Robyn is a certified training provider for GRI and has also served as a member of the GRIs Public Sector Working Group.

### 3. Net Balance's submission on the proposed amendments

Net Balance has reviewed the following consultation papers and ASX documents in preparation of our submission:

- Review of the Corporate Governance Principles and Recommendations
- Proposed Changes to ASX Listing Rules and Guidance Note 9
- Proposed Governance-Related Amendments to the ASX Listing Rules

We have also reviewed and referenced additional papers and reports supporting changes to corporate governance frameworks and disclosure requirements.

As a general observation, Net Balance commends the ASX's Corporate Governance Council for its proposed amendments to the Corporate Governance Principles and Recommendations, and the ASX's changes to its Listing Rules and Guidance Note 9 Disclosure of Corporate Governance Practices. We believe the changes to Guidance Note 9 reflects developments in corporate governance matters, both in Australia and overseas, and better addresses the deficiencies in corporate governance practices, particularly those relating to risk management.

This submission is in support of and seeks to make particular comment to the amendments to the ASX Principle 7 – Recognise and Manage Risk, and in particular Recommendation 7.4 which states "A listed entry should disclose whether, and if so how, it has regard to economic, environmental and social sustainability risks".

Net Balance supports efforts to increase transparency around the process of identifying, assessing and disclosing environmental, social and economic risks to stakeholders and providing information to demonstrate how these risks are being managed. We believe the proposed changes will drive companies to increase their understanding and management of their material economic, environmental and social risks, and better protect business value.



Net Balance believes the proposed Recommendation 7.4 can be further strengthened and aligned to the other recommendations under Principle 7 by being amended to the following (or similar):

# "A listed entity should disclose:

- (a) whether, and if so how, the risk committee, board or committee of the board, management, and internal audit function roles, have regard to economic, environmental and social sustainability risks, and
- (b) the processes it employs for assessing at least annually the impacts of economic, environmental and social sustainability risks on the material business risks the entity faces."

Following are our comments supporting the amendments:

# 3.1 Risk management

The OECD Steering Group on Corporate Governance concluded in its report into Corporate Governance and the Financial Crisis that the failure of organisational risk management was a significant contributor to the GFC.<sup>1</sup> A key finding was that risk management was too often focussed on internal controls for the purpose of financial reporting and that "risk management was divorced from strategy and its implementation".

### The report also observed that:

- Boards are often ignorant of the risks facing the company;
- The aim of risk management is not to eliminate risk, but to ensure that risks are understood, managed and, when appropriate, communicated;
- Boards should be involved in both establishing and overseeing the risk management structure;
- The process of risk management and the results of risk assessments should be appropriately disclosed and boards should ensure the organisation communicates material risks to the market; and
- Risk management is insufficiently covered by existing corporate governance standards and codes.

## 3.2 Economic, environmental and social sustainability risks

Shareholders increasingly recognise the importance of environmental, social and governance (ESG) factors on the longer term performance of companies. Despite this, the Australian Council of Superannuation Investors (ACSI) and the Financial Services Council (FSC) believe there is still a relative lack of integration of non-financial issues and risks factored into

<sup>&</sup>lt;sup>1</sup> OECD, Corporate Governance and the Financial Crisis: *Conclusions and emerging good practices to enhance implementation of the Principles, Directorate for Financial and Enterprise Affairs*, OECD Steering Group on Corporate Governance (2010).



mainstream investment decisions.<sup>2</sup> One of the key reasons stated was the lack of meaningful disclosure by many companies in relation to non-financial issues.

The majority of the ASX 50 do not disclose non-financial risks and associated management practices.<sup>3</sup> The proposed new Recommendation 7.4 will help address the need for further information required to undertake company valuations which underlie investment management decisions.

## 3.3 International regulatory developments in relation to reporting ESG issues

Recommendation 7.4 also seeks to take into account material developments and regulatory reporting requirements being introduced by international stock exchanges including South Africa, Hong Kong, Singapore, India, United Kingdom and Brazil.

In April 2013, the European Commission proposed an amendment to its accounting legislation requiring large companies to disclose relevant environmental and social management information in their annual reports. Where a company did not or could not disclose this information, it was required to explain 'why not'. The associated press release states that in addition to addressing the need for increased transparency, the amendment seeks to ensure companies are taking a longer term perspective into account when making business decisions.<sup>4</sup>

In South Africa, companies listed on the Johannesburg Stock exchange are required to produce a report integrating their financial and sustainability performance, or explain why they do not.

ASX Listing Rule 4.10.3 requires listed entities to include in their annual report a statement describing how the company has followed the Corporate Governance Principles and Recommendations over the reporting period. Where the company has not followed the Recommendations, they must provide a reason for not doing so. This listing rule therefore imposes the 'Report or Explain' requirement on Recommendation 7.4, in alignment with international practice.

# 3.4 Regulation will help drive change

While a large number of companies have voluntarily taken up reporting ESG risks and opportunities, there will continue to be a large number that will not embark of the assessment of ESG risk and disclosure without regulatory push. Regulation can serve to

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<sup>&</sup>lt;sup>2</sup> ibid

<sup>&</sup>lt;sup>3</sup> Association of Chartered Certified Accountants, *Adoption of integrated reporting by the ASX 50*, Dec 2011. Available at:

http://www2.accaglobal.com/pubs/general/activitiesx/library/sustainability/reporting\_pubs/tech-tp-air2.pdf

<sup>&</sup>lt;sup>4</sup> Commission moves to enhance business transparency on social and environmental matters, European Commission - IP/13/330, 16 April 2013. Available at: <a href="http://europa.eu/rapid/press-release\_IP-13-330\_en.htm">http://europa.eu/rapid/press-release\_IP-13-330\_en.htm</a>



instigate the need for reporting, prior to companies actually realising it is in their best interests to do so. It is also argued that market mechanisms (such as the ASX Listing Rules) are more effective tools for increasing the quantity of reporting than regulation, due to the fact that stock exchanges often appear to have more influence over companies than governments.<sup>5</sup> Furthermore, the non-prescriptive nature of the Listing Rules and Guidance Notes, allows companies to disclose information in the way they consider most relevant to them and their shareholders, and provides enough scope for companies to differentiate themselves.

Sustainability reporting (or non-financial reporting) is an important tool for encouraging sustainable development. Widespread reporting amongst listed companies will encourage more sustainable, responsible, business practices. It helps to ensure companies progress toward addressing their environmental and social impacts (externalities) for which society ultimately pays.

The requirement to report forces companies to evaluate risks by measuring their environmental and social impacts. Greater visibility of these impacts, we believe, will lead to better management.

## 3.5 Sustainability reporting is maturing

Net Balance believes the introduction of Recommendation 7.4 is well timed. Non-financial reporting is maturing and a growing number of companies are now measuring and disclosing sustainability information to complement their financial performance information. Ninety-five per cent of the 250 largest global companies now report on non-financial activities.<sup>6</sup>

Over the last few years, international best practice in reporting has developed and a number of frameworks for reporting on non-financial issues. The GRI, United Nations Global Compact (UNGC) and the International Petroleum Industry Environmental Conservation Association (IPIECA) have been adopted for use by Australia's listed companies.

Earlier this year, two global reporting frameworks released major documents intent on improving the standard of non-financial reporting over the coming years. The GRI released its G4 reporting framework and the International Integrated Reporting Council (IIRC) released the Draft International Framework for Integrated Reporting. Other organisations, such as the Sustainability Accounting Standards Board (SASB) in the USA, are developing lists of material issues by sector to help reporters and also promote consistency and comparability.

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<sup>&</sup>lt;sup>5</sup> Association of Chartered Certified Accountants, "Paragraph 47: international perspectives one year on", July 2013. Available at: <a href="http://www.accaglobal.com/content/dam/acca/global/PDF-technical/sustainability-reporting/tech-tp-para47.pdf">http://www.accaglobal.com/content/dam/acca/global/PDF-technical/sustainability-reporting/tech-tp-para47.pdf</a>

<sup>&</sup>lt;sup>6</sup> KPMG, KPMG International Survey of Corporate Responsibility Reporting, 2011



### 4. Conclusion

Net Balance commends the proposed introduction of Recommendation 7.4. It will enhance the risk management process in general, as well as highlighting the requirement for robust identification and control of economic, environmental and social sustainability risks. Recommendation 7.4 reflects international regulatory developments in ESG risk management and disclosure, and will help drive change in this area not only for ASX listed companies but for those who look to the ASX for best practice guidance. The Recommendation also supports the trend to disclose environmental, social and governance risk in sustainability reports, aimed at providing stakeholders with reliable and transparent information.

Thank you for the opportunity to provide comment on the ASX Corporate Governance Council's proposed third edition Corporate Governance Principles and Recommendations, and the ASX's proposed changes to its Listing Rules and Guidance Note 9 *Disclosure of Corporate Governance Practices*. We look forward to learning of the outcome of this consultation process.

Yours sincerely

Terence Jeyaretnam

Director

**Net Balance**