Submission by Professor Carol Adams PhD CA FCPA FAICD, Professor of Accounting at Swinburne Business School and Durham University Business School (UK) to the:

Consultation on the Review of the ASX Corporate Governance Council's Principles and Recommendations

8th June 2018

Thank you for the opportunity to respond to the **Review of the ASX Corporate Governance Council's Principles and Recommendations** at https://www.asx.com.au/regulation/corporate-governance-council/review-and-submissions.htm

I have served on a number of Boards and have been researching international governance and corporate reporting for around 25 years with a particular focus on the strategy, culture, broad value creation and non-financial reporting. I have been involved in the work of the Global Reporting Initiative (GRI), International Integrated Reporting Council (IIRC), Climate Disclosure Standards Board (CDSB) and in the AA1000 Standard series through their governance structures and/or technical work. I provide advice to companies and asset owners on corporate reporting integrating sustainable development risks and opportunities into strategy.

Please find below my response to your consultation questions concerning:

- **whether stakeholders agree with the nine proposed new recommendations and, if not, why not;**

Yes, but the recommendations in 3.3, 3.4 and 4.4 do not go far enough.

It is, however, pleasing to see the requirement in 2.2 that Boards consider including climate change and sustainability skills in Board matrices. In my research (Adams, 2017a)[1] interviewing Board Directors, including Directors of ASX20 and ASX100 companies, about social and environmental risks and opportunities, I found a lack of awareness and a lack of consideration of such risks. This was particularly the case for Australian Board Directors relative to those I interviewed in South Africa who attributed their increase in awareness of social and environmental risks to having a framework to guide them – The King Code.

Although having climate change and sustainability skills on the Board is important, it is not enough to ensure the associated risks are appropriately considered. For example, one Board Chairman of an infrastructure company with significant assets adjoining the ocean told me that that when a board member raised concerns about rising sea levels anticipated in the long term "We all laughed at him". Such risks are potentially significant and ought to be considered in Board decision making. The recommendations[2] of the Taskforce on Climate related Financial Disclosures should be made mandatory on an if not, why not basis, particularly for asset owners.

Issues concerning the Sustainable Development Goals (SDGs), climate change, longer term focus have been raised[3] and considered at the International Accounting Standards Board (IASB) in connection

[1] Adams, CA, (2017a) Conceptualising the contemporary corporate value creation process, *Accounting Auditing and Accountability Journal* 30 (4) 906-931 http://dx.doi.org/10.1108/AAAJ-04-2016-2529 Also available here
[2] https://www.fsb-tcfd.org/publications/final-recommendations-report/
[3] http://www.ifrs.org/-/media/feature/meetings/2017/november/iasb/wider-corporate-reporting/ap28a-wcr-mcps.pdf See Appendix 2B.

with the ongoing revision of their *Management Commentary – A Practice Statement*. It is appropriate that they are also explicitly considered in governance principles and related guidance. The UK's Financial Reporting Council also included these issues in its consultation on revisions to its Corporate Governance Code which closed earlier this year.

Adams (2017b)[4] published by the International Integrated Reporting Council and the Institute of Chartered Accountants of Scotland sets out an approach to developing a strategy to contribute to the Sustainable Development Goals aligned with the International <IR> Framework[5]. It was endorsed by the Chartered Accountants of Australia and New Zealand (CAANZ) in their response[6] to the Australian Senate Inquiry on the SDGs. The CAANZ submission, like many others, pointed to the need for appropriate governance structures at organisational/corporate level, as well as government level. This is necessary both in order to meet Australia's obligations to contribute to the SDGs and also to address sustainable development issues impacting on the long-term success of business and take advantage of associated opportunities.

- **whether stakeholders agree with the changes proposed to the existing recommendations in the third edition and, if not, why not;**

The recommendations under 7.4 are inadequate to ensure that risks impacting on companies and those who invest in them are identified and reported. Although it is pleasing to see the work of the IIRC, GRI and CDSB referenced, 'encouraging' companies to report using these frameworks/standards through the Corporate Governance Principles will not have the impact necessary to avoid significant risks and meet investment levels required to reduce carbon emissions to a safe level.

There is overwhelming evidence, from a substantial body of academic research on social and environmental sustainability related disclosures over a period of about three decades, that it is not until disclosure becomes a compliance requirement – which is enforced - that companies take appropriate action. There is substantial evidence that companies apply voluntary reporting recommendations and frameworks selectively and that they reference such frameworks and use corporate disclosures to manipulate public perception (see, for example Adams, 2004[7]). There is also evidence that mandatory disclosures which are not enforced are not complied with (see, for example Adams et al, 1995[8]).

Hence, reporting on the TCFD recommendations should be mandatory and enforced. This is the recommendation made in a report published this month by the UK Parliament's Environmental Audit Committee following its Green Finance Inquiry[9]. A shift towards Green Finance, through disclosure of climate change related financial risks, is an essential step to reducing carbon emissions and securing long-term economic prosperity. The Corporate Governance Principles should be firmer in this respect.

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[4] Adams, C A (2017b) *The Sustainable Development Goals, integrated thinking and the integrated report*, IIRC and ICAS. ISBN 978-1-909883-41-30 Available at http://integratedreporting.org/wp-content/uploads/2017/09/SDGs-and-the-integrated-report_full17.pdf

[5] http://integratedreporting.org/resource/international-ir-framework/

[6] https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Foreign_Affairs_Defence_and_Trade/SDGs

[7] Adams CA (2004). The ethical, social and environmental reporting – performance portrayal gap, *Accounting, Auditing and Accountability Journal* 17(5): 731–757.

[8] Adams CA, Coutts A and Harte GF (1995) Corporate equal opportunities (non) disclosure, *British Accounting Review* 27(2): 87–108.

[9] See https://drcaroladams.net/uk-green-finance-inquiry-report-concludes-climate-change-risk-reporting-should-be-mandatory/

- **specifically, whether stakeholders agree with the Council's proposal to include as part of recommendation 1.5 a requirement that entities in the S&P/ASX 300 set a measurable objective to have a minimum of 30% of directors of each gender on their boards by a specified date;**

Yes. Organisations without gender diverse boards are not selecting Board Directors from the entire qualified population and are therefore missing out on talent. Further, they are missing out on the different perspectives and different ways of thinking about risks, opportunities and strategic issues that a gender diverse board brings. Lack of gender diversity at the top perpetuates these problems through the organisation.

In research interviewing Board Directors (Adams, 2017a), male interviewees spoke about the ability of women to make connections between complex issues – a skill which is increasingly needed by Boards today.

- **whether stakeholders agree with the annual timeframes proposed for board reviews in recommendation 1.6 and management reviews in recommendation 1.7;**

Yes.

- **whether stakeholders agree with Council's proposed changes to box 2.3, setting out the factors relevant to assessing director independence;**

Yes.

- **whether the proposed amendments to principle 3 and the accompanying commentary deal adequately with governance-related concerns related to an entity's values, culture and social licence to operate;**

No. The principle 3 should explicitly refer to environmental responsibility. Use of the term 'social licence to operate' infers a passive response to risk referenced against what actions 'society' will bear today, with no consideration of future generations and long-term risks to sustainable development and economic prosperity. This approach has allowed businesses to deplete natural resources, contribute to climate change and contribute to local and global economic inequities. Further, it does not recognise the opportunities that arise from considering sustainable development issues.

Boards should explain how they are considering and addressing risks from climate change and sustainable development issues which impact on their ability to create value in the long term – or say why this disclosure is not made. This should consider both risks and opportunities presented by climate change and sustainable development issues in developing their strategy.

My research (Adams, 2017a[10]) interviewing top company Board directors demonstrated that the impact of Board governance on long term value creation in response to climate change and sustainable development issues is enhanced when Boards have a framework to guide them. The Corporate Governance Principles should emphasise the need to take a long-term focus and be cognisant of a wider range of risks and opportunities and set strategy accordingly (see Adams, 2017a).

[10] Adams, CA, (2017a) Conceptualising the contemporary corporate value creation process, *Accounting Auditing and Accountability Journal* 30 (4) 906-931 http://dx.doi.org/10.1108/AAAJ-04-2016-2529 Also available here

Further the Principles should reference the relevance to business and investors of the Sustainable Development Goals and the recommendations of the Financial Stability Board's Task Force on Climate related Financial Disclosure (TCFD) on long term value creation. Key global standard setters, including the GRI, IIRC, UN Global Compact, UNCTAD and the WBCSD, are providing guidance to companies on responding to the Sustainable Development Goals (SDGs). Companies should make explicit reference to the existence of sustainable development issues in the external environment which pose a risk to a company's ability to create value for shareholders and other stakeholders in the long term (see Adams, 2017a and b which demonstrate that sustainable development issues are relevant to long term value creation).

The recent Corporate Governance Code consultation by the UK's Financial Reporting Council and the UK Parliament's second Green Finance Inquiry report[11] explicitly called for input on Board involvement in these matters. The latter report has recommended that climate change risk reporting be mandatory for all asset owners by 2020 and enforced.

- **whether compliance with any of the new or amended recommendations might have any unforeseen consequences or give rise to undue compliance burdens for listed entities;**

No. Any perceived burden by listed companies of implementing these changes could not outweigh benefits. The negative consequences of Directors not considering the matters these changes address within their purview are significant.

- **whether the level of guidance in the draft fourth edition is appropriate and whether stakeholders would like more guidance on any particular principles or recommendations; and**

Yes. There is a range of publicly available guidance on these matters at no cost which you have referenced.

- **whether there are any other gaps or deficiencies in the *Principles and Recommendations* that have not been addressed by the proposed changes in the consultation draft of the fourth edition.**

Yes. See my comments above with respect to:

- **consideration of the impact of climate change risks and sustainable development risks on long term value creation;**
- **making the TCFD recommendations mandatory** (particularly for asset owners);
- **developing enforcement mechanisms;**
- **ensuring that ASX companies assist the Australian Government in meeting its commitment to contribute to the UN Sustainable Development Goals by following the approach set out in Adams, C A (2017b) *The Sustainable Development Goals, integrated thinking and the integrated report*, IIRC and ICAS. ISBN 978-1-909883-41-30** (Available at http://integratedreporting.org/wp-content/uploads/2017/09/SDGs-and-the-integrated-report_full17.pdf.) **This should include consideration of these risks by asset owners.**

[11] See https://drcaroladams.net/uk-green-finance-inquiry-report-concludes-climate-change-risk-reporting-should-be-mandatory/