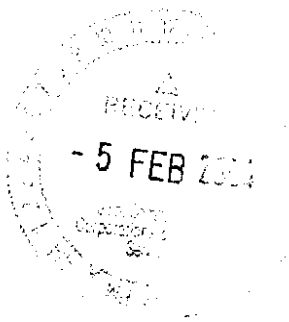

Australian
Conservation
Foundation

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Submission to Treasury
on
CLERP (Audit Reform and Corporate Disclosure) Bill 2003

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This submission is endorsed by: Climate Action Network Australia Friends of the Earth Australia, Oxfam Community Aid Abroad and The Wilderness Society.

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1. Introduction

This submission is made to the Commonwealth Treasury with respect to the exposure draft of the *CLERP (Audit Reform and Corporate Disclosure) Bill 2003* (the Bill).

Who We Are

The Australian Conservation Foundation (ACF) is one of Australia's leading non-government environmental organisations. For nearly forty years, we have voiced the desire of Australians to conserve the natural environment, uniting progress and environmental protection. Most recently, ACF, along with civil society worldwide, has given increasing attention to the environmental and social responsibilities of the modern corporation and wider corporate governance issues.

What this submission will do

This submission sets out:

(1) ACF's recommendation to enhance corporate disclosure by requiring annual sustainability reporting in accordance with the Global Reporting Initiative; and

(2) ACF's support of the proposed strengthening of requirements relating to the disclosure of executive compensation arrangements and recommendation to require specific disclosure of performance hurdles for incentive-based compensation; and

(3) ACF's recommendation to strengthen existing laws regarding disclosure of major shareholdings by mandating disclosure of the top 20 beneficial owners of listed equities, with enhanced enforcement powers to compel disclosure from non-beneficial holders.

Endorsement

This submission is endorsed by Climate Action Network Australia, Friends of the Earth Australia, Oxfam Community Aid Abroad and The Wilderness Society.

2. Schedule 2, Part 3 – Content of directors' report for listed public companies – Corporate sustainability disclosure

In addition to the new requirements set out in proposed Section 299A, ACF recommends a significant strengthening of existing environmental disclosure provisions in Paragraph 299(1)(f).

Current disclosure requirements and international trends

Australia's corporate environmental disclosure laws do not require systematic environmental reporting and are significantly behind international trends and best practice. There are two generally applicable disclosure requirements in Australia:

1) Corporations Law paragraph 299(1)(f), which requires disclosure of performance in relation to significant environmental regulations; and

2) the National Pollutant Inventory, which requires disclosure of certain emissions (not including CO_2, the major greenhouse gas pollutant).

All other aspects of environmental performance reporting have been left to voluntary initiatives. This has, with few exceptions, been a dismal failure. Australian investors and the community currently have less information about corporate environmental performance available to them than in almost any other industrialised nation.

The past decade has seen a spate of new sustainability reporting requirements around the world, with comprehensive disclosure laws or rules being enacted in France, Denmark, the Netherlands, Norway, South Africa and Sweden, among others.[1] France, for example, requires detailed disclosure of water, energy and other resource consumption; greenhouse and other emissions; waste management; impacts on biodiversity; management policies and procedures; and compliance issues. Even more notably, the European Commission has issued a recommendation that all member states ensure environmental performance reporting in company annual reports, specifically mentioning quantitative disclosure of emissions and consumption of energy, water and materials.[2] Progressive convergence of European requirements towards international best practice is therefore already underway. In the USA, a group of major institutional investors is pressuring the SEC to strengthen its enforcement of existing laws regarding disclosure of environmental risks.

So far, Australia has turned a blind eye to these important international developments. The chart attached as Annex A, which compares mandatory environmental reporting requirements and reporting practice in selected nations, illustrates just how far behind Australia actually is. In addition to the lack of any legal requirements regarding resource usage, greenhouse emissions, waste management and other important issues, Australia's actual rates of environmental reporting are among the lowest in the industrial world.

The quality of disclosure also leaves much to be desired. A typical section 299(1)(f) disclosure is that of Woolworths in its 2002 Annual Report. The disclosure reads, in full, as follows:

> Except as set out below, the operations of the Group are not subject to any particular and significant environmental regulation under a law of the Commonwealth of Australia or of any of its States or Territories.
>
> The 'Woolworths Plus Petrol' operations are subject to regulations and standards governing the construction and operation of the facilities relating to the storage and dispensing of petroleum products.
>
> The Group may also from time to time be subject to various State and Local Government food licensing requirements and environmental and town

[1] Useful summaries of international developments include Tareq Emtairah, *Corporate Environmental Reporting: Review of Policy Action in Europe* (International Institute for Industrial Environmental Economics, February 2002), available at http://www.enviroreporting.com/others/cer_europe.pdf; Global Reporting Initiative and UNEP (2001), *Government Initiatives to Promote Corporate Sustainability Reporting Roundtable* (Paris, 18 June 2001); and Mark Mansley, *Open Disclosure: Sustainability and the listing regime* (February 2003), available at http://www.foe.co.uk/resource/reports/open_disclosure.pdf.

[2] Commission Recommendation of 30 May 2001 on the recognition, measurement and disclosure of environmental issues in the annual accounts and annual reports of companies (2001/453/EC).

> planning regulations incidental to the development of shopping centre sites.
>
> As outlined on pages 21 and 22, the Supermarket Division has implemented a number of environmental initiatives.
>
> The Group has not incurred any significant liabilities under any environmental legislation.

That's 126 words (plus discussion of a few specific initiatives), representing the sum total of publicly reported information on the environmental performance of the fifth largest company in Australia in 2002. (Note that the report discusses "liabilities" rather than "performance", as required by section 299(1)(f), and refers only to "significant liabilities", thus adding a materiality qualification to the disclosure where there isn't one in the law.)

Woolworths is not particularly unusual in this respect. According to recent survey by KPMG, a mere 14% of the top 100 Australian companies issue stand-alone environmental reports – less than half of the corresponding percentage in the USA and most European countries, and less than one third of the percentage of the Global Fortune Top 250 companies.[3] Interestingly, Japan, which does not mandate any disclosure (aside from a pollution register), has the highest rate of sustainability reporting in the world. Nearly ¾ of major Japanese corporations issue annual environmental or sustainability reports, most of which contain detailed quantitative data on performance. It's fair to say that corporate Japan has embraced corporate sustainability reporting *en masse*,[4] which stands in marked contrast to the lacklustre corporate response to Environment Australia's 2000 *Framework for Public Environmental Reporting: An Australian Approach.*

Leadership in sustainability reporting by a few Australian companies, concentrated in the mining sector, hasn't been followed by the rest. Section 299(1)(f) has had some positive effects,[5] but it represents a baseline of required information about compliance that should be greatly expanded. In ACF's experience, reliance on voluntary sustainability reporting in Australia has resulted in predominantly selective disclosures that highlight a few company initiatives or positive developments, while ignoring negative results and failing to provide comprehensive data that would permit objective comparisons or analyses of environmental performance over time.

The rationale for comprehensive sustainability disclosure

Comprehensive environmental disclosure has a wide range of benefits. Highlighted below are 5 of the most important ones, in the Australian context.

(1) **Better environmental outcomes.** Public disclosure requirements may tend to improve environmental performance. According to the US Environmental Protection Agency, "public availability of information regarding environmental performance and compliance will result in market forces that can positively influence en-

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[3] KPMG, *International Survey of Corporate Sustainability Reporting 2002*, available at http://www.kpmg.co.uk/services/ras/pubs.cfm#.

[4] See Chris Knight & Paul Scott, "Japanese disclosure sets the pace", *Environmental Finance* July/August 2001, p.30.

[5] See Geoffrey Frost & Linda English, "Mandatory Corporate Environmental Reporting in Australia: Contested Introduction Belies Effectiveness of Its Application", *Australian Review of Public Affairs* (November 2002), available at http://www.econ.usyd.edu.au/drawingboard/digest/0211/frost.html.

vironmental behaviour."[6] Conversely, weak requirements enable poor performers to hide their behaviour from public and government scrutiny, resulting in a lack of accountability and a perverse competitive disadvantage for good performers.

(2) **Better business performance.** There is good evidence that public reporting improves financial performance by creating organisational structures to monitor and improve resource and waste efficiency, as well as by suggesting strategic business opportunities and raising environmental awareness overall. Of 195 Australian companies responding to a recent survey of the perceived benefits of public environmental reporting commissioned by the Australian Government, 59% thought that public reporting brought about operational and management improvements, 40% thought that it created market opportunities, 77% thought that it enhanced reputation, and 52% thought that it improved risk management.[7]

(3) **More objective information.** A standard reporting framework would increase the objectivity and quality of investor and community information sources, such as ratings of corporate responsibility and recommendations by ethical investment advisers. It was partly for these reasons that The Mays Report (commissioned by the Australian Government) recommends the establishment of "common standards for reporting of social and environmental data ... along the same lines as the accounting standards."[8]

(4) **Streamlined analyst and community information requests.** There is currently a good deal of frustration in the corporate sector regarding multiple, duplicative and sometime voluminous requests for information about social and environmental performance from NGOs, investors, SRI fund managers, ratings agencies, analysts, and others. Standardised, universal reporting would lessen the number of these requests considerably, and narrow the scope of those that remain, since a large volume of information would already be publicly available.

(5) **A level playing field.** Currently, a small number of Australian companies engage in comprehensive reporting. BHP Billiton and Westpac are leaders, being the only Australian companies to report fully in accordance with the Global Reporting Initiative (GRI) guidelines.[9] WMC stands out as well as the only Australian company producing a report rated among the best 50 reports worldwide in a recent survey by SustainAbility and the UNEP.[10] However, until all companies report at this level, the poor environmental performers will not be forced to internalise fully the environmental costs of their activities.

Proposed reporting requirements

The GRI sustainability reporting guidelines are now widely accepted by the international business community as the best set of indicators for sustainability reporting. ACF recommends that the federal government amend 299(1)(f) to introduce mandatory sustain-

[6] U.S. Environmental Protection Agency, *Enforcement Alert*, October 2001.
[7] *The State of Public Environmental Reporting in Corporate Australia*, March 2003, available at http://www.deh.gov.au/industry/finance/publications/state-of-per/index.html.
[8] *Corporate Sustainability – an Investor Perspective: The Mays Report*, 2003 (available at http://www.deh.gov.au/industry/finance/publications/mays-report/index.html)
[9] See www.globalreporting.org for details.
[10] SustainAbility and UNEP, *Trust Us. The Global Reporters 2002 Survey of Corporate Sustainability Reporting*, (London, 2002).

ability reporting for disclosing entities based on (or referring to) the GRI sustainability reporting guidelines.

In the alternative, an independent set of reporting requirements could be developed. The Department of Environment and Heritage has developed set of environmental management and performance indicators based on the GRI, but modified for the Australian context.[11] These could be used as the basis for mandatory reporting indicators.

Finally, enhanced sustainability reporting will be effective only if there are adequate enforcement mechanisms. Following the lead of several European countries,[12] the federal government should establish a Minister for Corporate Responsibility, whose portfolio would include enforcement of reporting requirements, among other responsibilities. Alternately, an independent body within ASIC or DEH could be established with appropriate staffing dedicated solely to monitoring sustainability reporting and with the power to compel compliance and to impose meaningful penalties for breaches of the requirements.

3. Schedule 5 – Remuneration of directors and executives

ACF supports the proposed revisions to Paragraphs 300A(1)(a) and (c), which strengthen disclosure obligations regarding board and executive compensation arrangements. These revisions should a specific obligation to disclose incentive-based compensation performance hurdles.

It is crucial for investors and other stakeholders to be able to ascertain not only the amount and nature of executive compensation, but also the specific performance criteria according to which incentive-based compensation is granted. In ACF's view, the way in which executive incentives are structured is more important than overall compensation levels in ensuring proper appraisal of long-term risk and economically and environmentally sustainable corporate behaviour.

Currently, many corporate executives have little incentive to take a long-term view of corporate risks and returns. This is because most or all of their performance-based compensation is tied to short-term financial performance metrics, such as earnings per share or revenue. An executive who is granted an annual bonus based on revenue (short-term) and stock options that will vest in several years (medium-term) has a personal interest in encouraging quick returns at the expense of, for example, investment in long-term research and development or pollution controls that may pay off only over a 20- or 30-year time frame.

Yet, the relevant time horizon for large institutional investors (such as pension funds) can be up to 30 years. Such an investor is unable to assess the long-term prospects of a company adequately without knowing the precise incentives under which its management is operating. The Australian community more generally also has a strong interest in encouraging sustainable corporate behaviour, and monitoring companies that fail to structure corporate incentives appropriately.

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[11] *Triple Bottom Line Reporting in Australia – A Guide to Reporting Against Environmental Indicators*, June 2003.

[12] See *The State of Public Environmental Reporting in Corporate Australia*, March 2003, at http://www.deh.gov.au/industry/finance/publications/state-of-per/aust-overseas.html#overseas.

In this respect, it is encouraging that the explanatory notes to the Bill envision that future regulations will require "disclosure of information such as performance hurdles to which the payment of options or long term incentives of directors and executives are subject; why such performance hurdles are appropriate and the methods used to determine whether performance hurdles are met." However, given the importance of these requirements, and their apparent acceptance at this point, there is no reason why they should not be given a clear statutory basis, rather than left to the vicissitudes of the regulatory process.

Proposed Amendments

Amend Paragraph 300A(1)(c) to read as follows:

> (c) for each of the persons set out in paragraph (d):
> (i) details of all performance hurdles to which the payment of any of their remuneration is subject; and
> (ii) discussion of why such performance hurdles are appropriate; and
> (iii) discussion of the methods used to determine whether such performance hurdles are met; and
> (iv) such other details concerning their remuneration as may be prescribed in the regulations.

Insert a new Paragraph 300A(1)(d), listing the persons currently set out in proposed Paragraph 300A(1)(c).

4. Disclosure of Major Shareholders

The widespread practice of concealing share ownership through use of nominee or custodian companies reduces corporate accountability and threatens existing statutory requirements relating to disclosure of substantial shareholdings in listed companies. A new provision should be inserted into the Corporations Law requiring disclosure of the top 20 beneficial owners of each class of listed equities of a listed entity.

Existing requirements

Companies listed on the ASX are currently required to disclose in their annual report "the names of the 20 largest holders of each class of quoted equity securities, the number of equity securities each holds and the percentage of capital ... each holds."[13] Since a large proportion of many companies' capital is held through nominee or custodial companies rather than directly by the actual beneficial owners, this disclosure is often less than illuminating. Rio Tinto's disclosure in its 2002 annual report is entirely typical:

RIO TINTO LIMITED		Number of shares	Percentage of issued share capital
1	Tinto Holdings Australia Pty Limited	187,439,520	37.58
2	JP Morgan Nominees Australia Limited	53,655,695	10.76
3	National Nominees Limited	46,976,034	9.42

[13] Australian Stock Exchange, Listing Rule 4.10.9, available at http://www.asx.com.au/about/l3/ListingRules_AA3.shtm.

4	Westpac Custodian Nominees Limited	34,353,815	6.89
5	Citicorp Nominees Pty Limited	10,689,088	2.14
6	Commonwealth Custodial Services Limited	7,702,102	1.54
7	MLC Limited	6,695,581	1.34
8	ANZ Nominees Limited	6,675,133	1.34
9	AMP Life Limited	6,561,213	1.32
10	Queensland Investment Corporation	6,508,975	1.30
11	HSBC Custody Nominees (Australia) Limited	4,614,005	0.92
12	Cogent Nominees Pty Limited	4,117,395	0.83
13	The National Mutual Life Association of Australasia Limited	2,805,676	0.56
14	Citicorp Nominees Pty Limited <CFS WSLE IMPUTATION FND A/C>	2,793,910	0.56
15	RBC Global Services Australia Nominees Pty Limited	2,745,694	0.55
16	RBC Global Services Australia Nominees Pty Limited	2,487,227	0.50
17	ING Life Limited	2,388,792	0.48
18	Citicorp Nominees Pty Limited <CFS WSLE Geared SHR FND A/C>	2,262,416	0.45
19	Citicorp Nominees Pty Limited <CFS WSLE AUST SHARE FND A/C>	2,141,040	0.43
20	RBC Global Services Australia Nominees Pty Limited	1,730,888	0.35
		395,344,199	79.26

Of Rio Tinto Limited's top "20" nominal shareholders (actually, only 15 separate entities are named), at least 14 are custodial companies with no beneficial interest in their holdings, totalling 36.68% of the companies issued share capital. The largest shareholder, Tinto Holdings Australia, is a wholly-owned subsidiary of the UK-listed Rio Tinto plc, the largest 20 shareholders of which are *all* nominees.

There is no way of knowing who the beneficial owners of these shares are, since nominee companies are not required to, and do not in fact, disclose them. The defect lies not with Rio Tinto, which couldn't necessarily obtain complete information about beneficial ownership even if it wanted to,[14] but in the legally sanctioned opacity of nominee companies.

This utter lack of transparency has two major consequences. First, it greatly facilitates evasion of Corporations Law Chapter 6C, which requires disclosure of substantial shareholdings. In theory, ASIC has the power to investigate nominee companies and require disclosure of the beneficial owners. In practice, however, these powers are of little consequence, for there is no mechanism by which non-compliance would trigger any suspicion on the part of the regulator in the first place. A number of recent reports by the OECD recognise the potential for abuse and note that sanctions for failing to declare shareholdings are "very difficult to enforce" because of nominee companies.[15]

Second, the ability of owners to hide behind a veil of nominee companies severely compromises corporate social and environmental accountability. The financers of harmful activities are effectively rendered immune from public scrutiny and criticism. The nominees proclaim their passivity and lack of control, while the true owners remain anony-

[14] Corporations Law Section 672A(1) permits a listed company to direct a member to disclose relevant beneficial interests, but a listed company generally has no reason to issue such a direction, and enforcement powers are weak in any event, especially vis-à-vis holding companies resident outside of Australia.
[15] Eddy Wymeersch, *Current Reform Initiatives: Challenges and Opportunities*, (OECD, December 2000), p.45, available at http://www.oecd.org/dataoecd/20/51/1857259.pdf. See also OECD, *Options for Obtaining Beneficial Ownership and Control Information* (September 2002), available at http://www.oecd.org/dataoecd/50/40/1961539.pdf.

mous and unaccountable for their actions. The most recent annual report of the Mining Ombudsman illustrates, for example, how nominees are used to insulate the financers of mining companies from local community expressions of concern about the environmental and human rights consequences of mining activities.[16]

Nominees have a legitimate role in facilitating ownership of shares by foreign entities and increasing the efficiency of capital markets. These legitimate purposes do not require maintaining the anonymity of beneficial owners of shares, especially when direct owners are not entitled to such anonymity.

Proposed Amendments

The Corporations Law should be amended to require disclosure in a company's annual report of the "names of the 20 largest *beneficial owners* of each class of quoted equity securities, the number of equity securities each holds and the percentage of capital each holds."

In order to ensure that companies will be able to obtain complete information, existing powers to compel disclosure from non-beneficial holders of securities should be strengthened. In particular:

- The current provision in Corporations Law Section 672B(1) that disclosure of beneficial shareholder information need only be made "to the extent to which it is known to the person required to make the disclosure" should be repealed. If inaccurate information is provided to a nominee, the solution is not to excuse the nominee from compliance with the law. Instead, the nominee company should have recourse against the beneficial owner for any damages caused by the inaccurate information.

- The proper remedy for failure to make adequate disclosure of beneficial shareholder information to a listed company should not be damages, as currently provided in Corporations Law Section 672F. In this context, the damage is to the market and the community generally, rather than to the listed company itself. Damages awarded under Section 672F are not likely to be significant, and therefore do not provide a real incentive to comply with the law, especially for foreign entities. A more effective remedy would be forfeiture of the relevant securities, after adequate notice and an opportunity to correct any deficiencies in the disclosure.

Given the importance of this measure in ensuring compliance with Corporations Law Part 6C, as well as the important interest in ensuring corporate accountability more generally, it is appropriate that this requirement be located in the Corporations Law and not in the listing requirements of individual stock exchanges.

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[16] *Mining Ombudsman Annual Report 2003*, (Oxfam Community Aid Abroad 2003), pp 16-18, available at http://www.caa.org.au/campaigns/mining/ombudsman/2003/index.html.

ɔrate Environmental Disclosure Requirements and Practice

Germany	Japan	Netherlands	Norway	South Africa	UK	USA
No specific requirement	No specific requirement	Disclosure of incidents, complaints and their resolution	Major compliance orders, but only at listing of new securities	Required by JRE Listing Rules, by reference to GRI	No specific requirement; legislative proposals pending	Disclosure if liability incurred material or greater than $100K
No specific requirement	No specific requirement	No specific requirement	Disclosure of risk of accidents and expected "limitations"	No specific requirement	No specific requirement; legislative proposals pending	Material environmental risks (but widespread non-compliance)
EPER Register (EU requirement) for certain large industrial sites	No requirement	Required by Environmental Reporting Decree	Required by Law of Accounts	Required by JSE Listing Rules, by reference to Global Reporting Initiative	Pollution Inventory (EU requirement) for certain large industrial sites	No general requirement, but some states require limited disclosure
	PRTR Law					Toxic Release Inventory
No requirement	No requirement				No requirement	No requirement
No requirement	No requirement				No requirement	No requirement
No requirement	No requirement				No requirement	No requirement
No requirement	No requirement	No requirement			No requirement	Some states require disclosure of raw material inputs
No requirement	No requirement	No requirement			No requirement	No requirement
No requirement	No requirement				No requirement	No requirement
No requirement	No requirement				No requirement	No requirement
No requirement	No requirement	Implied by Environmental Reporting Decree	Implied by Law of Accounts		No requirement	No requirement
Required for pension funds	No requirement	No requirement	No requirement	Fund managers must disclose their voting of equity securities	Required for pension funds	No requirement