

# CHAPTER 7

## SUSTAINABILITY REPORTING: CURRENT LEGISLATIVE AND MARKET REQUIREMENTS

7.1 In Australia, there is no legal requirement for sustainability reporting per se. However there are certain obligations on companies to report both financial and non-financial information in a number of areas. Submitters' views on the appropriateness of current reporting requirements were highly polarised. Corporations and business associations almost unanimously agreed that the current arrangements are appropriate whereas accounting bodies, non-governmental organisations and consultants in general agreed that there is scope for improvement.

7.2 This chapter looks at the existing reporting requirements, for both financial and non-financial information. The financial reporting framework is covered in some detail in the recognition, as some submitters suggested, that existing provisions for disclosure of financial information could be extended to include non-financial information. As Professor Deegan submitted:

...there is nothing to preclude the introduction of [non-financial] performance-related disclosures within these sources of regulation...<sup>1</sup>

7.3 Matters discussed in this chapter include:

- Statutory requirements for financial reporting;
- Reporting requirements of the Australian Stock Exchange (ASX) Corporate Governance Council Recommendations;
- The current review of the ASX Corporate Governance Council Recommendations;
- Other ASX requirements; and
- Statutory requirements for non-financial reporting.

### **Statutory requirements for financial reporting<sup>2</sup>**

7.4 Existing statutory requirements for financial reporting are intended to provide structure, comparability and transparency. Some of these requirements are also relevant to sustainability reporting. There are broadly two ways in which listed companies formally disclose information to the market: continuous disclosure and periodic disclosure.

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1 Professor Craig Deegan, *Submission 96*, p. 7.

2 This section is in part based on: Corporations and Markets Advisory Committee, *Corporate Responsibility Discussion Paper*, November 2005; Mr Richard Turner, *Submission 5*; and Professor Craig Deegan, *Submission 96*.

### ***Continuous disclosure***

7.5 The regulation governing continuous disclosure is contained in the *Corporations Act 2001* (Corporations Act) and is complemented by the ASX Listing Rules.<sup>3</sup> Under ASX Listing Rule 3.1 listed corporations are required to disclose immediately any information that a reasonable person would expect to have a material effect on the price or value of the entities securities.

7.6 Section 677 of the Corporations Act defines 'material effect on price or value' stating it as information that:

...would, or would be likely to, influence persons who commonly invest in securities in deciding whether to acquire or dispose of the [enhanced disclosure] securities.

7.7 Whilst Listing Rule 3.1 is focused primarily on financial issues, it potentially also covers information relating to environmental and social matters that satisfies the materiality test. The ASX Guidance Note on continuous disclosure makes clear that in making continuous disclosures, the listed corporation has an equal duty to shareholders, investors and the market generally.<sup>4</sup> As the interest of institutional investors in corporate responsibility grows, and as the impacts of a company's non-financial performance on overall company value are better understood, this mechanism may become important for disclosures of sustainability information.

7.8 The Australian Human Rights Centre cited the 2003 Ernst & Young report, *The Materiality of Environmental Risk to Australia's Finance Sector* as an indication that materially significant environmental risk is currently under-reported by ASX companies.<sup>5</sup> Mr Spathis of the Australian Council of Super Investors (ACSI) supported this view saying that a recent study conducted by Monash University found that 'information on the material risks was either unavailable or difficult to obtain'.<sup>6</sup> The committee hopes that this trend diminishes as corporations increasingly recognise the importance of non-financial risks to their longer-term financial performance.

7.9 Similar obligations apply to unlisted disclosing entities under the Corporations Act.<sup>7</sup>

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3 *Corporations Act 2001*, ss. 674–678; ASX Listing Rule 3.1.

4 Australian Stock Exchange, *Guidance Note 8: Continuous Disclosure: Listing Rule 3.1*, June 2005, p. 3.

5 Australian Human Rights Centre, *Submission 20*, p. 8.

6 Mr Phillip Spathis, Executive Officer, Australian Council of Super Investors, *Committee Hansard*, 5 April 2006, p. 66.

7 *Corporations Act 2001*, para. 675(1)(b).

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### *Periodic disclosure*

7.10 The regulations governing the disclosure of company financial information in annual reports is contained in the *Corporations Act 2001*, Accounting Standards, and Australian Stock Exchange listing requirements (for listed entities).

7.11 All companies (other than some small private companies) and registered managed investment schemes must prepare and file with ASIC an annual report, comprising:

- a financial report; and
- a directors' report.<sup>8</sup>

### *Financial report*

7.12 The Corporations Act prescribes the content of the financial report, including compliance with the accounting standards.<sup>9</sup> Some matters that could be included within a non-financial reporting framework can have direct financial implications. However, there is no requirement that environmental and social aspects of a company's operations be covered in the financial report.<sup>10</sup>

### *Directors' report – operating and financial review*

7.13 The directors' report covers a range of general information concerning the operation of the company, including its principal activities and outcomes during the year, as well as some forward-looking information.<sup>11</sup> Of particular interest is the introduction of an operating and financial review (OFR, also known as the management discussion and analysis, MD&A) contained in section 299A. Under this provision listed companies are required to include in the directors' report any information that shareholders would reasonably require to make an informed assessment of:

- the operations of the company reported on;
- its financial position; and
- the company's business strategies and its prospects for future financial years.

7.14 The OFR obligation aims to ensure greater transparency and accountability within the company's operations and greater opportunity for stakeholders to take an interest in the business operations of the company.

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8 *Corporations Act 2001*, ss. 292–294.

9 *Corporations Act 2001*, ss. 295–297.

10 Corporations and Markets Advisory Committee, *Corporate Responsibility Discussion Paper*, November 2005, p. 80.

11 *Corporations Act 2001*, ss. 298–300A.

7.15 Section 299A was introduced in response to a recommendation in the Royal Commission report *The Failure of HIH Insurance* (April 2003).<sup>12</sup> The Royal Commissioner referred to the proposals in the United Kingdom for an OFR (discussed previously in chapter 6), containing such information that the directors decide is necessary to obtain an understanding of the business, including details of the company's performance, plans, opportunities, corporate governance and management risks.

7.16 Section 299A does not specify the same level of detail as was required in the comprehensive UK OFR provisions, which, for instance, specifically referred to risks and information about the impact of the business on the environment, employees or other interests. Instead, the Explanatory Memorandum to section 299A stated that the provision was intentionally expressed in broad terms:

- to enable directors to make their own assessment of the information needs of shareholders of the company and tailor their disclosures accordingly; and
- to provide flexibility in form and content of the disclosures, as the information needs of shareholders, and the wider capital market, evolve over time.<sup>13</sup>

7.17 The Explanatory Memorandum directs companies to the G100's *Guide to Review of Operations and Financial Condition* (the G100 Guide), which significantly, makes reference to both company stakeholders and the provision of financial and non-financial information. The G100 Guide notes:

A contemporary Review should include an analysis of industry-wide and company-specific financial and non-financial information that is relevant to an assessment of the company's performance and prospects.<sup>14</sup>

7.18 In various sections, the G100 Guide makes reference to non-financial aspects of business operations including:

The Review should include a discussion and analysis of *key financial and non-financial performance indicators* (KPIs) used by management in their assessment of the company and its performance ... Where practical, KPIs ... should include multiple perspectives such as *sustainability measures*

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12 See Explanatory Memorandum to Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 para 4.391 and Royal Commission report *The Failure of HIH Insurance*, April 2003, vol 1 at p. 182 and Recommendation 13.

13 Explanatory Memorandum to Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003, para 5.306.

14 Group of 100, *Guide to Review of Operations and Financial Condition*, 2003, p. 7, available at [www.group100.com.au/publications/g100\\_Review\\_Operations2003.pdf](http://www.group100.com.au/publications/g100_Review_Operations2003.pdf) (accessed 10 May 2006).

*including social and environmental performance measures, where relevant.*<sup>15</sup> [emphasis added]

The Review should provide a commentary on the strengths and resources of the company whose value may not be fully reflected in the statement of financial position ... Disclosure of *information about unrecognised intangible assets* such as ... *human resources, customer and supplier relationships and innovations* is helpful to users in making decisions.<sup>16</sup> [emphasis added]

The Review should contain discussion of the company's risk profile and risk management practices... All relevant aspects of risk management ... should be discussed. ... The discussion of the risk profile, management and mitigation of risk ... may include:

- Availability of staff and other resources;
- Occupational health and safety;
- Environmental issues; and
- Product liability.<sup>17</sup>

7.19 The Corporations and Markets Advisory Committee noted the potential importance of this development stating:

The provision applies to annual reports of listed companies from 2005. While potentially a significant development, it will take some time to assess any change in quantity or quality of information reported as a result of the new provision.<sup>18</sup>

7.20 Several corporate representative bodies such as the Australian Bankers Association and the Australian Institute of Company Directors argued that the OFR requirements set out in section 299A provide adequate scope for companies to report their operational and financial performance.<sup>19</sup> In contrast, environmental groups such as the Australian Conservation Foundation argued that it is unlikely that this provision will result in greater disclosure of specific environmental data for most companies.<sup>20</sup>

7.21 The committee is of the view that the OFR in combination with the G100 guide provide an effective mechanism for companies to disclose, and for investors to assess and value, material non-financial performance, risk profile and risk

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15 Group of 100, *Guide to Review of Operations and Financial Condition*, 2003, p. 12.

16 Group of 100, *Guide to Review of Operations and Financial Condition*, 2003, p. 21.

17 Group of 100, *Guide to Review of Operations and Financial Condition*, 2003, p. 22.

18 Corporations and Markets Advisory Committee, *Corporate Responsibility Discussion Paper*, November 2005, p. 83.

19 Australian Bankers Association, *Submission 106*, p. 16; Australian Institute of Company Directors, *Submission 73*, p. 17.

20 Australian Conservation Foundation, *Submission 21*, p. 32.

management strategies. The committee believes that the non-financial disclosures that result from this new mechanism should be closely monitored by company auditors to ensure that disclosures are meeting the evolving needs of shareholders and the wider capital market.

### **Recommendation 8**

**7.22 The committee recommends that each company auditor on an annual basis:**

- **review the extent to which companies are making non-financial disclosures in their Operating and Financial Reviews; and**
- **make recommendations to the company Board regarding the adequacy of the disclosures to meet the evolving needs of shareholders, and the wider capital market in order to assess and value material non financial performance, risk profile and risk management strategies.**

### **Requirements of the Corporate Governance Council Recommendations**

7.23 In response to a number of high-profile corporate collapses which occurred in Australia and overseas throughout 2001 and 2002, the ASX Corporate Governance Council released its *Principles of Good Corporate Governance and Best Practice Recommendations* (the ASX Council Recommendations).<sup>21</sup> ASX Listing Rule 4.10.3 requires companies to provide a statement in their annual report disclosing the extent to which they have followed the 28 ASX Council Recommendations, which are framed under ten Principles of Good Corporate Governance. The ASX Council Recommendations are said to be neither mandatory nor prescriptive. They point out that '[i]f a company considers that a recommendation is inappropriate to its particular circumstances, it has the flexibility not to adopt it – a flexibility tempered by the requirement to explain why.'<sup>22</sup> Where companies have not followed a recommendation, they must give reasons for taking an alternative approach. This is referred to as the 'if not, why not' obligation.

7.24 During the inquiry the Chair of the ASX Corporate Governance Council, Mr Eric Mayne was asked whether he thought the 'if not, why not' mechanism has the practical effect of making the ASX Council Recommendations quasi-mandatory. Mr Mayne acknowledged that companies tend to regard them as 'somewhat prescriptive' because the recommendations essentially set a framework for companies'

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21 In this regard the Committee notes the comments of CPA Australia: 'Over recent years Australian business, government and community have witnessed some unacceptable corporate conduct. Each incident reinforces a growing disconnect between the expectations of community and the practices of some corporations. However, each incident also serves to emphasise that inappropriate practices are not the norm, and the vast majority of today's business leaders regularly display high levels of competence and integrity.' (CPA Australia, *Submission* 103, p. 3).

22 ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 5.

responses. However, Mr Mayne agreed that in disclosing information about corporate governance practices, companies are responding to market expectations and that market forces should dictate how companies respond.<sup>23</sup>

7.25 The results from the ASX's recently released review of disclosures in 2005 annual reports (discussed below) suggest that companies don't see the ASX Council Recommendations as prescriptive, as 26 per cent of the market chose not to adopt the recommendations or adopted an alternative practice.<sup>24</sup>

7.26 Despite being criticised as a 'lost opportunity'<sup>25</sup> and 'benign in many ways'<sup>26</sup> the ASX Council Recommendations were generally viewed as a positive mechanism to encourage listed companies to improve their corporate governance practices. Corporate ResponseAbility described their strength as giving 'both a high level overview and clear direction without being overly prescriptive.'<sup>27</sup>

7.27 Although the ASX Council Recommendations are specifically designed to encourage improved corporate governance practices, three of the ten principles contained in the ASX Council Recommendations are directly relevant to the disclosure of sustainability information. These are:

- Principle 3: Promote ethical and responsible decision-making;
- Principle 7: Recognise and manage risk; and
- Principle 10: Recognise the legitimate interests of stakeholders.

***Principle 3: Promote ethical and responsible decision-making***

7.28 As discussed in chapter 6, ASX Council Recommendation 3.1 creates an expectation for publicly listed entities to establish a code of conduct to actively promote ethical and responsible decision making. The ASX Council Recommendations state 'investor confidence can be enhanced if the company clearly articulates the practices by which it intends directors and key executives to abide.'<sup>28</sup> Depending on the content of the code of conduct, the confidence other company stakeholders have in the company could also be enhanced. For example the

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23 Mr Eric Mayne, Chair, Australian Stock Exchange Corporate Governance Council, *Committee Hansard*, 10 March 2006, p. 6.

24 Australian Stock Exchange, *Analysis of Corporate Governance Practices reported in 2005 Annual Reports*, May 2006, p. 2, available at [http://www.asx.com.au/about/pdf/corporate\\_governance\\_2005\\_disclosure.pdf](http://www.asx.com.au/about/pdf/corporate_governance_2005_disclosure.pdf) (accessed 23 May 2006).

25 Professor Craig Deegan, *Submission 96*, p. 15.

26 Mr Tim Sheehy, Chief Executive, Chartered Secretaries Australia, *Committee Hansard*, 23 November 2005, p. 50.

27 Corporate ResponseAbility, *Submission 93*, p. 5.

28 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 25.

ASX Council Recommendations suggest that the code of conduct could include 'fair dealing by all employees with the company's customers, suppliers, competitors and employees' which would obviously provide these stakeholders with a degree of enhanced confidence.

***Principle 7: Recognise and manage risk***

7.29 Of all the principles, Principle 7 is perhaps the most closely aligned with one of the key characteristics of corporate responsibility – risk management. Principle 7 refers to listed companies establishing 'a sound system of risk oversight and management and internal control' designed to:

- identify, assess, monitor and manage risk; and
- inform investors of material changes to the company's risk profile.

7.30 In order to satisfy this principle, Recommendation 7.1 specifies that the board or appropriate board committee should establish policies on risk oversight and management.

7.31 According to the guidance on Recommendation 7.1 the policies should include a risk profile component, which 'should be a description of the material risks facing the company. *Material risks include financial and non-financial matters.*<sup>29</sup> [emphasis added]

7.32 The guidance to Principle 7 goes on to state that a description of the company's risk management policy and internal compliance and control system should be made publicly available, ideally by posting it to the company's website in a clearly marked corporate governance section.<sup>30</sup>

7.33 Recommendation 7.2 is also potentially relevant to a company's management of non-financial risks. It states that:

The chief executive officer (or equivalent) and the chief financial officer (or equivalent) should state to the board in writing that ... the company's risk management and internal compliance and control system is operating efficiently and effectively in all material respects.<sup>31</sup>

7.34 The requirement set out in this Principle is for the disclosure of material risks, be they financial or non-financial. The question of materiality is by its nature a subjective one. As a result, whether companies disclose information on non-financial risks under this Principle will depend on whether it is seen as material by each

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29 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 44.

30 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 45.

31 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 45.



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individual organisation. Despite this uncertainty, this Principle is clearly relevant to the concept of corporate responsibility.

***Principle 10: Recognise the legitimate interests of stakeholders***

7.35 This Principle refers to listed companies establishing and disclosing a code of conduct to guide compliance with their legal and other obligations to legitimate stakeholders. It sets out various suggestions for matters to be covered by that code of conduct.

7.36 Guidelines for the content of the code of conduct are provided and include reference to:

- Responsibilities to clients, customers and consumers;
- Employment practices – such as occupational health and safety; special entitlements above the statutory minimum; training and further education support; and prohibitions on the offering and acceptance of bribes;
- Responsibilities to the community – this might include environmental protection policies, support for community activities, donation or sponsorship policies; and
- How the company complies with legislation affecting its operations – for example for companies that operate outside Australia, whether those operations comply with Australian or local legal requirements.

7.37 Principle 10 requires listed companies to publish (ideally in a clearly marked corporate governance section on their website) a description of any applicable code of conduct or a summary of its main provisions. They should also include within their annual report an explanation of any departure from the best practice recommendation in Principle 10.

7.38 2004 was the first year that listed companies were required to provide disclosure against the ASX Council Recommendations. In May 2005 the ASX released a report on the corporate governance disclosures reported in 2004 annual reports. This report indicates that the average adoption rate for all ASX Council Recommendations for the whole market was 68 per cent and almost 85 per cent for the top-500 companies.<sup>32</sup> The NSW Young Lawyers observed that 'this indicates a clear acceptance of the principles at the board-room level.'<sup>33</sup>

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32 ASX Corporate Governance Council, *Analysis of Corporate Governance Practices reported in 2004 Annual Reports*, May 2005, p. 3.

33 New South Wales Young Lawyers Pro Bono and Community Services Taskforce, *Submission 65*, p. 18.

7.39 The updated 2005 report was recently released by the ASX, and this report indicates an improved trend in overall adoption of the ASX Council Recommendations.<sup>34</sup>

7.40 During the course of the inquiry, adaptation of the ASX Council Recommendations was often referred to as a possible option for encouraging a greater level of sustainability reporting in Australia. Options for adaptation are discussed below.

### **Review of the Corporate Governance Council Recommendations<sup>35</sup>**

7.41 In September 2005, Senator the Hon Ian Campbell, Minister for the Environment and Heritage, asked the ASX Corporate Governance Council to consider the development of a voluntary reporting framework for sustainability reporting. Recognising that reporting against a standardised framework would increase comparability and make reports more relevant to business and other stakeholders, the Minister asked the Council to consider options on how to enhance comparability. In particular, the Minister recommended consideration of an agreed reporting framework using an 'if not, why not' approach to allow for greater comparability, whilst maintaining the principle of voluntary sustainability reporting.

7.42 Following the request by Senator Campbell, the ASX Corporate Governance Council set up a working group to consider how best to encourage greater non-financial reporting.

7.43 The working group reported to ASX Corporate Governance Council in December 2005. To capture industry views the ASX Corporate Governance Council has agreed to prepare a consultation document which will address:

- What corporate responsibility means;
- Which companies it should apply to;
- Which aspects should be left to the market (i.e. voluntary disclosure) and which aspects should be suggested or mandated (i.e. what the reporting framework should be); and
- What the benefits to investors and the community and the markets will be and whether those benefits outweigh additional compliance costs.<sup>36</sup>

7.44 During his appearance before the committee Mr Mayne indicated four possible options to enhance the ASX Council Recommendations in response to Senator Campbell's request:

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34 ASX Corporate Governance Council, *2005 Analysis of Corporate Governance Practice Disclosure*, May 2006, p. 2.

35 The section utilises information provided by the Australian Stock Exchange, *Submission 124*, and the Department of the Environment and Heritage, *Submission 116*.

36 Australian Stock Exchange, *Submission 124*, p. 6.

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- A voluntary, standardised reporting framework such as the GRI;
  - Providing further guidance;
  - Providing further guidance and the inclusion of a reporting trigger; and
  - Await the findings of the Parliamentary Joint Committee on Corporations and Financial Services as well as the report from the Corporations and Markets Advisory Committee.<sup>37</sup>

7.45 Mr Mayne elaborated on all four options, which are discussed in more detail below.

***Option 1: Incorporate a standardised framework***

7.46 On the first option, to incorporate a standardised framework such as the GRI, Mr Mayne acknowledged the advantages of a standardised reporting framework, such as providing structure, rigour and comparability to sustainability reports, and highlighted a range of concerns including the diversity of the market, the potential for greenwash, and the possibility that it would become a prescriptive framework.<sup>38</sup>

7.47 The majority of submitters that favour enhancing the non-financial disclosure requirements under the ASX Council Recommendations preferred this option, although there was disagreement on which framework should be adopted. For example, KPMG suggest that the ASX Corporate Governance Council should be encouraged to include sustainability reporting in the ASX Council Recommendations and that an Australian framework for sustainability reporting be established that is consistent with international requirements such as the GRI for use by those reporting entities which elect to issue sustainability reports.<sup>39</sup>

7.48 As an alternative the Ethical Investment Association recommended the inclusion of a United Kingdom style OFR as the standardised framework under the ASX Council Recommendations. Mr Turner suggested that draft guidelines for environmental and social reporting from the Department of Environment and Heritage (DEH) and Department of Family and Community Services and Indigenous Affairs (FaCSIA) be used. The Public Law Clearing House recommended the inclusion of a

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37 Mr Eric Mayne, Chair, Australian Stock Exchange Corporate Governance Council, *Committee Hansard*, 10 March 2006, p. 5.

38 Mr Eric Mayne, Chair, Australian Stock Exchange Corporate Governance Council, *Committee Hansard*, 10 March 2006, p. 9.

39 Mr Michael Bray, Partner, KPMG, *Committee Hansard*, 24 February 2006, pp 37–38.

disclosure framework referable to universal standards of assessing corporate conduct, presumably an instrument such as the UN Global Compact.<sup>40</sup>

7.49 Mr Mayne threw some doubt on this option by saying:

The council working group that has been looking at this particular option, I think it is fair to say, probably does not favour that as the option that should go forward.<sup>41</sup>

*Committee view*

7.50 The committee notes that this view of the Council working group may be somewhat premature, given that it is a view formed prior to the release of the Council's industry consultation paper. The committee supports greater comparability of sustainability information from the perspective of:

- financial markets, in terms of valuing non-financial risk management performance;
- corporations, for the purpose of benchmarking best practice; and
- public interest, for the purpose of corporate transparency.

7.51 A lack of comparability undermines the utility of sustainability reporting and also reduces public confidence in the considerable corporate responsibility activities that Australian companies are pursuing. Over time the absence of a standardised sustainability reporting framework will raise questions over the genuine commitment of Australian corporations in this area.

7.52 The committee also believes that the 'if not, why not' model of the ASX Council Recommendations provides sufficient flexibility for those corporations which choose to undertake sustainability reporting, but which also wish to use an alternative framework. Furthermore, the committee notes the inherent flexibility built into a standardised framework such as the GRI, allowing companies to tailor the reporting structure to suit their own needs. For these reasons the committee strongly supports Senator Campbell's referral to the ASX Corporate Governance Council, and encourages the Council to consider fully the development of a voluntary reporting framework for sustainability reporting.

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40 Ethical Investment Association, *Submission 105*, p. 4; Mr Richard Turner, *Submission 5*, p. 50; and Public Law Clearing House (Vic) Inc, *Submission 66*, p. 14, respectively. Other submissions that suggested including a reporting framework in the ASX Council Recommendations, without specifying a preferred framework included the Governance and Corporate Social Responsibility Research Unit, Curtin Business School, Curtin University of Technology, *Submission 128a*, p. 3; Professor Bryan Horrigan, *Submission 14*, p. 7; and Volunteering Australia, *Submission 36*, p. 5.

41 Mr Eric Mayne, Chair, Australian Stock Exchange Corporate Governance Council, *Committee Hansard*, 10 March 2006, p. 9.

7.53 Despite the committee's strong support for a voluntary sustainability reporting framework and the widespread acceptance of the GRI as the emerging international standard for sustainability reporting, the committee believes that it is too early to recommend the GRI as the voluntary Australian standard. The diversity of opinion over the appropriate framework for inclusion in the ASX Council Recommendations demonstrates that there remains uncertainty as to which framework is preferable to suit Australian market conditions. It is also prudent prior to nominating the GRI as the Australian standard, to consider the Australian sustainability framework currently under development by CPA Australia and the University of Sydney.

7.54 It is worth noting however that the *State of Sustainability Reporting in Australia 2005* shows a clear trend for Australian based companies to report 'with reference' to the GRI Framework.<sup>42</sup> If this trend continues, Australian corporations will become more familiar and comfortable with the GRI Framework, particularly once Australian organisations gain experience with the revised and improved G3, and the Australian Government should reconsider the suitability of the GRI as the Australian sustainability reporting standard.

### **Recommendation 9**

**7.55 The committee recommends that:**

- **it is premature to adopt the Global Reporting Initiative Framework as the voluntary Australian sustainability reporting framework; and**
- **that the Australian Government continue to monitor the acceptance and uptake of the Global Reporting Initiative Framework, both nationally and internationally, with a view to its suitability as the, or a basis for a, voluntary Australian sustainability reporting framework.**

7.56 Despite not recommending the GRI Framework as the voluntary Australian standard, the committee believes there is value in promoting its greater acceptance and uptake in Australia. In chapter 8 the committee makes a recommendation to promote the GRI Framework to Australian corporations including small to medium enterprises.

### ***Option 2: Provide further guidance***

7.57 On the second option, to provide further guidance on the existing ASX Council Recommendations, Mr Mayne noted the merit of this approach in giving greater clarity to the listed entities, but acknowledged that it would be a temporary one to two year arrangement depending on company take-up.<sup>43</sup> It can be inferred from Mr Mayne's remarks that if, after one or two years, companies were not using the additional guidance to improve their non-financial disclosures, then more detailed

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42 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 4.

43 Mr Eric Mayne, Chair, Australian Stock Exchange Corporate Governance Council, *Committee Hansard*, 10 March 2006, p. 9.

requirements would be necessary. Submitters preferring a less structured approach, such as the Australian Institute of Company Directors, favoured this option.<sup>44</sup>

7.58 The need for clearer guidance was illustrated by the fact that despite the reasonably strong adoption rate of the ASX Council Recommendations, several submitters questioned the adequacy of the content of disclosures. For instance RepuTex submitted:

...compliance [with the ASX Council's Recommendations] may be deemed adequate even if it amounts to merely a brief sentence or paragraph. This is not the desired outcome of the [ASX Council Recommendations], which are deliberately flexible to reflect the diverse nature of Australian companies.<sup>45</sup>

7.59 Several specific subject areas were brought to the committee's attention which may warrant further guidance in the ASX Council Recommendations. For instance the committee was referred to a report by the Centre for Australian Ethical Research, entitled *Just how business is done? A review of Australian business' approach to bribery and corruption*.<sup>46</sup> The report found that 51 per cent of the ASX 100 companies have stated policies which address bribery and corruption amongst their officials, which compares with 92 per cent in the UK, 80 per cent in the US and 91 per cent in Europe. The report suggests that 'the ASX does not currently suggest corruption as an issue for inclusion in a business ethics codes.'<sup>47</sup>

7.60 Two organisations representing or advising institutional investors also raised concerns over the adequacy of disclosures. Evidence from Mr Spathis of ACSI demonstrates that, although the ASX Council Recommendations are a step in the right direction:

The anecdotal feedback I am getting from our and other representatives on the ASX Corporate Governance Council is that the feedback from corporations on principle 7 has been pretty light on.<sup>48</sup>

7.61 These concerns were echoed by BTGAS which submitted that there needs to be greater consideration of the responses companies give under Principles 7 and 10.<sup>49</sup>

7.62 BTGAS provided several compelling examples which clearly illustrate why certain non-financial risks are becoming so important to both institutional investors

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44 Australian Institute of Company Directors, *Submission 73*, p. 17.

45 RepuTex Ratings & Research Services, *Submission 86*, p. 16.

46 Dr Judy Henderson, Global Reporting Initiative, *Committee Hansard*, 10 March 2006, p. 27.

47 Centre for Australian Ethical Research, *Just how business is done? A review of Australian business' approach to bribery and corruption*, March 2006, p. 3.

48 Mr Phillip Spathis, Executive Officer, Australian Council of Super Investors, *Committee Hansard*, 5 April 2006, p. 67.

49 BT Governance Advisory Service, *Submission 19*, p. 5.

and to companies' longer term financial position. For instance it submitted that Australian work-related injuries are estimated to cost Australian companies \$27 billion per annum, with indirect costs potentially up to four times greater. In relation to energy and greenhouse risks BTGAS cited analysis by the Carbon Disclosure Project which indicates that a five per cent increase in energy prices could impact per share earnings by as much as 15 per cent in certain industries.<sup>50</sup>

7.63 Finally, the ASX Corporate Governance Council's recently released review of 2005 corporate governance disclosures seems to confirm that the sustainability information being provided to the market is ad hoc and inconsistent. The report found deficiencies in relation to Principle 7 disclosures, stating 'while many companies referred to responsibility for risk management ... fewer companies actually reported on the policies in place or disclosed a description of these policies.'<sup>51</sup>

7.64 The report's sustainability and corporate responsibility section also demonstrates that some companies do not have a full understanding of what is expected in the disclosures they make. For instance, sustainability and corporate responsibility disclosures were not necessarily made in the context of a specific principle. Where companies did refer to a Principle they referred to Principles 1, 3, 4, 7 and 10 or a combination of these Principles.<sup>52</sup> This suggests that further guidance is required regarding the disclosure of non-financial information. This is particularly true given the ASX Corporate Governance Council's view that 'meeting the information needs of a modern investment community is also paramount in terms of accountability and attracting capital.'<sup>53</sup>

7.65 ACSI put forward a proposal to encourage corporations to disclose a level of non-financial performance information that is material to their long term financial performance. Essentially the proposal is for companies to self-identify the non-financial risks that are of greatest importance to the organisation. ACSI suggest that corporations should self-identify their top five sustainability risks and the strategies and mechanisms planned, or in place, to manage them. Ms McCluskey of the fund manager Portfolio Partners, who appeared before the committee with ACSI, noted that BHP Billiton had used this approach in its 2004 *Health Safety Environment*

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50 BT Governance Advisory Service, *Submission 19*, p. 8.

51 ASX Corporate Governance Council, *2005 Analysis of corporate governance practice disclosure*, May 2006, p. 12.

52 ASX Corporate Governance Council, *2005 Analysis of corporate governance practice disclosure*, May 2006, p. 13.

53 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 3.

*and Community Report*, which was 'very effective'.<sup>54</sup> By comparison with BHP Billiton's annual report disclosure in response to the Principle 7, the top five sustainability risk disclosure is far more user friendly and informative.

#### *Committee view*

7.66 The committee concluded that only limited non-financial performance information is being provided to the market. This is a particular concern of institutional investors which as discussed in chapter 5 have an obligation to consider long term risks, such as those posed by environmental and social risks. Given the apparent inadequacy of non-financial disclosures that are currently being made under Principles 3, 7 and 10, the committee believes that it is appropriate to provide further guidance and clarity regarding the extent of non-financial information expected.

7.67 In the committee's view the ASX Corporate Governance Council should provide further guidance on Recommendation 7.1 regarding how companies should achieve the non-financial aspect of the 'risk profile' component of the 'policies on risk oversight and management'.<sup>55</sup> In particular, an ASX Guidance Note should clearly articulate that companies should inform investors of material non-financial aspects of the company's risk profile by disclosing their top five sustainability risks, as well as the associated management strategies in the 'risk management' section.

7.68 The benefit of this approach is that it would provide companies with a large degree of flexibility as they would be able to self-identify the most appropriate sustainability risks for their business. This flexibility would be coupled with the inherent flexibility of the 'if not, why not' formulation of the ASX Council Recommendations. It would provide investors with an indication of a company's major non-financial risks and the strategies being pursued to manage, minimise or take advantage of those risks.

7.69 The ASX Corporate Governance Council should also use its discussion paper as a mechanism to consult with companies, investors and other stakeholders regarding other areas where greater clarification and guidance is required under Principles 3, 7 and 10 in relation to non-financial performance, risks and management.

### **Recommendation 10**

**7.70 The committee recommends that the Australian Stock Exchange Corporate Governance Council (ASX Council) provide further guidance to**

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54 Ms Amanda McCluskey, Sustainability Manager, Portfolio Partners, *Committee Hansard*, 5 April 2006, p. 69. BHP Billiton's *Health Safety Environment and Community Report 2004* is available from [www.bhpbilliton.com.au/bbContentRepository/Reports/bhpb\\_full\\_hsec\\_report\\_04.pdf](http://www.bhpbilliton.com.au/bbContentRepository/Reports/bhpb_full_hsec_report_04.pdf), pp 16-20 (accessed 10 May 2006).

55 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 44.



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**Principle 7 of the ASX Council's *Principles of Good Corporate Governance and Best Practice Recommendations* to the effect that companies should inform investors of the material non-financial aspects of a company's risk profile by disclosing their top five sustainability risks (unless they demonstrate having fewer); and providing information on the strategies to manage such risks.**

### **Recommendation 11**

**7.71 The committee recommends that the ASX Council undertake industry consultation to determine whether there are areas where companies, investors, and other stakeholders believe further guidance is necessary in relation to the non-financial disclosure requirements under the ASX Council's *Principles of Good Corporate Governance and Best Practice Recommendations*.**

7.72 In recommending that the ASX Council formulates further guidance, the committee highlights what it sees as an important consideration in providing such information that is its accessibility and utility to financial markets. If non-financial disclosures are to be relevant to financial analysts they must be in a form that is readily accessible. The committee heard evidence that 'corporate Australia is being run by an Excel spreadsheet.'<sup>56</sup> These sorts of considerations should be taken into account so that material disclosures of sustainability risks are as effective as possible.

7.73 In recognition that it is not only the disclosure of material non-financial information that is leading to undervaluation of sustainability risks, but also the way it is used, the following chapter discusses this issue and sets out a complementary recommendation to raise awareness amongst investors of material sustainability risks.

7.74 In relation to the specific bribery and corruption example mentioned above, the committee notes that the ASX Council Recommendations already suggests that, in relation to employment practices, a company code of conduct 'might include reference to ... prohibitions on the offering and acceptance of bribes'.<sup>57</sup> Given the recent publicity in this area, it may be appropriate for the ASX Corporate Governance Council to elaborate further on what is expected.

### ***Option 3: Further guidance plus a reporting trigger***

7.75 The third option being considered by the ASX Council as advised by Mr Mayne is to include further guidance within the Principles, and in addition to require a reporting trigger. The committee interpreted this trigger to imply the inclusion of a new recommendation within the ASX Council Recommendations for companies of a certain size or ranking to disclose publicly sustainability information.

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56 Mr Erik Mather, Head, BT Governance Advisory Service, *Committee Hansard*, 10 March 2006, pp 68–69.

57 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 60.

7.76 In relation to this proposal, Mr Mayne indicated that 'it may well be too soon to embark upon that area' and that it would depend on feedback from the discussion paper.<sup>58</sup>

7.77 Regarding this option the committee notes two broad categories of recommendation it received. These were:

- full sustainability reporting; and
- a minimum benchmark approach.

7.78 Full sustainability reporting was advocated by a number of submitters, either in the context of the ASX Council Recommendations or as a requirement under the Corporations Act.<sup>59</sup> Various submitters including most corporations and industry bodies opposed full sustainability reporting.<sup>60</sup>

7.79 This option differs from Mr Mayne's first option in that, in the case of the ASX Council Recommendations, it would specify an 'if not, why not' requirement for sustainability reporting rather than specifying a sustainability reporting framework for companies that voluntarily chose to report.

7.80 The general thrust of a minimum benchmark approach is for companies, within an overall voluntary sustainability reporting framework, to disclose a minimum level of non-financial performance information that is vital to companies' long-term financial performance. Within the ASX Council Recommendations such an approach would have the flexibility inherent in its 'if not, why not' model.

7.81 This approach was advocated by organisations such as AMP Capital Investors Sustainable Funds, which proposed the following four specific key performance indicators as minimum non-financial performance indicators: non-compliance with law; occupational health and safety performance; greenhouse gas emissions; and political donations.<sup>61</sup> Mr Berger of the Australian Conservation Foundation added a potential option to streamline this concept when he suggested 'a minimum threshold

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58 Mr Eric Mayne, Chair, Australian Stock Exchange Corporate Governance Council, *Committee Hansard*, 10 March 2006, pp 9–10.

59 For example the Australian Conservation Foundation, *Submission 21*, p. 34; Oxfam, *Submission 45*, p. 6; KPMG, *Submission 53*, p. 7; Australian Centre for Corporate Social Responsibility, *Submission 63*, pp 5–6; Gippsland Community Legal Service, *Submission 79*, p. 8; Professor Craig Deegan, *Submission 96*, p. 5; Dr Sean Cooney, *Submission 104*, p. 2; Ethical Investment Association, *Submission 105*, p. 4; and Futureye, *Submission 119*, p. 9.

60 For example Philanthropy Australia, *Submission 23*, p. 14; Australian Institute of Company Directors, *Submission 73*, p. 4; Shell Australia, *Submission 74*, p. 11; Credit Union Services Corporation (Australia) Limited, *Submission 77*, p. 3; Business Council of Australia, *Submission 108*, p. 51; British American Tobacco Australia, *Submission 112*, p. 5; and Mr Alex Gosman, Director, Government and Corporate Affairs, GlaxoSmithKline, *Committee Hansard*, 23 February 2006, p. 44.

61 AMP Capital Investors Sustainable Funds, *Submission 30*, pp 1–2.

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so that companies such as investment vehicles that have trivial or negligible [greenhouse] impacts are exempt from those reporting requirements.<sup>62</sup>

*Committee view*

7.82 The committee does not favour a full sustainability reporting approach. It has the potential to become a requirement that promotes form over substance. The committee believes that it is vitally important for companies to be encouraged strongly to engage voluntarily in sustainability reporting rather than being forced to do so. The committee heard evidence from several of Australia's leading performers in the area of corporate responsibility (such as Insurance Australia Group and ANZ Bank) of the significant shift in an organisation's culture which is required to integrate fully the concept of sustainability into its core business practices and structures. Imposing a sustainability reporting requirement, even with the inherent flexibility of the 'if not, why not' framework, could force those Australian companies which to date have not fully engaged in the corporate responsibility debate, into a knee-jerk and ill-considered attempt to comply with a sustainability reporting requirement. This would result in such companies developing a piecemeal and minimalist approach, rather than integrating the concept of corporate responsibility into the corporation's core operations and activities in a manner that best suits the company and its stakeholders. In the committee's view a well thought through and integrated approach that has sufficient time to develop properly will be far more effective than one that is forced on companies. The committee is also concerned to ensure that any approach is cost-effective for Australian business, particularly smaller listed companies.

7.83 The committee is more favourably disposed to a minimum benchmark approach. The committee acknowledges the legitimate need of a growing number of institutional investors and fund managers to have access to information regarding non-financial risks and company management strategies to deal with those risks.

7.84 On balance however, the committee is of the view that the minimum benchmark approach is more rigid and inflexible than the approach whereby companies are able to self-identify relevant risks. The committee notes that although major non-financial risks may be common within industry sectors (for example OH&S and energy use within the mining sector), because different industry sectors will typically have different major non-financial risks, a minimum benchmark approach may need to be varied according to the industry sector. There already exist a number of regulatory and market-based mechanisms by which companies, if the market dictates, are able to disclose such additional non-financial information. These include the Operating and Financial Review (section 299A of the Corporations Act), and the Review of Operations and Activities (ASX Listing Rule 4.10.17 discussed below). As investors and other stakeholders demand more non-financial information,

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62 Mr Charles Berger, Legal Adviser, Australian Conservation Foundation, *Committee Hansard*, 24 February 2006, p. 83.

the ASX could consider options to enhance the non-financial disclosure aspects of the Review of Operations and Activities or the ASX Council Recommendations.

#### ***Option 4: Await inquiry recommendations***

7.85 On the fourth option, to await the recommendations of both this committee and the CAMAC, Mr Mayne commented that 'I suspect that that is probably not an option that we would embark upon.'<sup>63</sup>

#### *Committee view*

7.86 The committee believes that this option is an internal matter for the ASX Corporate Governance Council to determine. The committee expects the ASX to take account of this report and to refer to the helpful submissions to this inquiry.<sup>64</sup>

### **Other Australian Stock Exchange requirements**

7.87 Apart from the requirements under the ASX Council Recommendations, ASX Listing Rule 4.10.17, which relates to the Review of Operations and Activities, is relevant to sustainability reporting.

7.88 This listing rule is based on section 299 of the Corporations Act. The guidance note to that Listing Rule states that, while the ASX does not require the review to follow any particular format, it supports the Group of 100 publication, *Guide to the Review of Operations and Financial Condition* (the G100 Guide).

7.89 The G100 Guide, which is reproduced in Guidance Note 10 of the ASX Listing Rules, makes clear that there is scope within the existing ASX Listing requirements for social and environmental information to be provided within the Review of Operations and Activities, with specific reference to the associated risks.

### **Non-financial reporting**

7.90 Many submissions pointed to two existing requirements within the Corporations Act for the disclosure of specific non-financial information.

#### ***Paragraph 299(1)(f)***

7.91 Paragraph 299(1)(f) of the Corporations Act requires disclosure of details of a company's performance in relation to any significant Commonwealth, state or territory environmental regulation that the company's operations are subject to. This mandatory

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63 Mr Eric Mayne, Chair, Australian Stock Exchange Corporate Governance Council, *Committee Hansard*, 10 March 2006, p. 10.

64 Submissions are available on the committee's website at [www.aph.gov.au/senate/committee/corporations\\_ctte/corporate\\_responsibility/index.htm](http://www.aph.gov.au/senate/committee/corporations_ctte/corporate_responsibility/index.htm)

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requirement applies to all entities that are required to prepare financial statements under the Corporations Act.

7.92 The Australian Human Rights Centre referred to studies which indicate that the introduction of paragraph 299(1)(f) significantly improved overall reporting by Australian companies on their environmental performance.<sup>65</sup>

7.93 On the other hand there was criticism of the value of this provision, both in relation to informing investors, and in terms of its overall effectiveness. For example it was submitted that paragraph 299(1)(f):

...doesn't allow investors to fully understand or price risk derived from companies and directors who fail to adequately internalise potential costs of breaches of environmental law. Hence, unless the breach is financially material, there is little incentive for analysts to price the risk into the valuation model. Meanwhile, the environmental damage has occurred and there is little ongoing incentive to redress or alter internal (company) risk management procedures (such as a formal environmental management system).<sup>66</sup>

7.94 The Australian Conservation Foundation was also critical of this provision saying:

...it is so riddled with qualifications that most companies provide no meaningful information, even when they have breached environmental laws during the relevant period. Companies also commonly read a 'materiality' qualification into the clause, which eviscerates it.<sup>67</sup>

7.95 ASIC also raised doubts about the effectiveness of paragraph 299(1)(f). Mr Cooper said that the provision did not encourage more of the resources sector to report more broadly on sustainability issues and that global forces are much more important in this regard.<sup>68</sup>

### ***Paragraph 1013D(1)(l)***

7.96 The other provision in the Corporations Act that requires disclosure of specific non-financial information is paragraph 1013D(1)(l). This provision requires issuers of investment products (such as superannuation products, managed investment products and investment life insurance products) to include in a Product Disclosure Statement 'the extent to which labour standards or environmental, social or ethical considerations are taken into account in the selection, retention or realisation of the

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65 Australian Human Right Centre, *Submission 20*, p. 9.

66 United Nations Environment Programme Finance Initiative Australasian Operational Environmental Management and Reporting Advisory Committee, *Submission 127*, p. 4.

67 Australian Conservation Foundation, *Submission 21*, p. 31.

68 Mr Jeremy Cooper, Deputy Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 29 March 2006, p. 23.

investment.' The provision applies specifically to investment products and is not a general requirement for the disclosure of non-financial information.

7.97 In December 2003, ASIC released the *Section 1013DA disclosure guidelines*, which are designed to help product issuers meet their obligations under paragraph 1013D(1)(l). According to the ASIC guidelines they:

...do not set out what constitutes a labour standard or an environmental, social or ethical consideration, or what methodology product issuers should use for taking these issues into account. The guidelines do, however, make it clear that you must disclose *which* of these standards and considerations you take into account and *how*. If you have no predetermined approach, then this too must be clear. The more a product is marketed on the basis that such standards and considerations are taken into account, the more detail is required.<sup>69</sup>

7.98 Ms McCluskey of Portfolio Partners suggested that ASIC should revise its guidance on section 1013D to make it relevant to mainstream fund managers rather than for the more limited pool of ethical funds:

...the [ASIC] guidance note that is associated with [the section 1013D] disclosure requirement is a guidance note for socially responsible and ethical funds reporting; it is not a guidance note for mainstream funds. From first-hand experience, it is very difficult for a mainstream manager to report to that guidance note. If that could be reviewed to be applicable not just to socially responsible and ethical funds but to all managers, I think you would have better reporting by fund managers on what they are doing to incorporate whatever you want to call it—sustainability issues. The super funds can then compare what the different fund managers are doing. I think that would better allow the super funds to get a window into how the fund managers are doing this, because there is a varying level of consideration. That is one thing that I think could give the super funds something better to work with, because those disclosures are really quite basic.<sup>70</sup>

7.99 The Financial Services Institute of Australasia (Finsia) submitted that under ASIC Policy Statement 175.110, licensees are advised to form their own view about how far section 945A (the 'know your client' rule) requires that inquiries be made into a client's attitude to environmental, social or ethical considerations. This was said to be at best 'a matter of good practice', but there are no requirements for advisers to broach these issues, and therefore SRI-style options with their clients.<sup>71</sup>

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69 Australian Securities and Investment Commission, *Section 1013DA disclosure guidelines*, December 2003, p. 3.

70 Ms Amanda McCluskey, Sustainability Manager, Portfolio Partners, *Committee Hansard*, 5 April 2006, p. 71.

71 Financial Services Institute of Australasia, *Submission 146*, p. 10.

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7.100 Finsia went on to suggest further research and engagement with the financial planning industry and consumer groups on the possibility of including environmental, social and governance considerations explicitly under section 945A.

*Committee view*

7.101 The committee supports the need to revise the ASIC guidelines to make them relevant to mainstream fund managers. Such a revision would allow super funds to compare the approaches that different fund managers are taking to the consideration of non-financial information. The committee notes that the ASIC guidelines state: 'we intend to review these guidelines, in light of market conduct, in the first half of 2006.'<sup>72</sup>

**Recommendation 12**

**7.102 The committee recommends that the Australian Securities and Investments Commission revise the *Section 1013DA disclosure guidelines* to be relevant to mainstream fund managers rather than simply to the more limited pool of ethical investment funds.**

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72 Australian Securities and Investment Commission, *Section 1013DA disclosure guidelines*, December 2003, p. 3.

