Submission to the Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into Corporate Responsibility and Associated Reporting

Submission prepared by:

Professor Craig Deegan
Professor of Accounting and Director of Research
School of Accounting and Law
RMIT University, Melbourne

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Introduction

This submission concentrates on the reporting dimension associated with corporate social and environmental responsibilities. This submission starts by firstly providing a summary of some relevant research conducted by the author of this submission and which has investigated corporate social and environmental reporting behaviour. In the context of the research evidence, various recommendations will then be provided. These recommendations are made with respect to improving the future quality of Australian social and environmental performance reporting.

Evidence pertaining to corporate social and environmental performance reporting within Australia

The research discussed below represents a limited selection of the research undertaken by the author of this submission. This research is of direct relevance to the current inquiry. A brief summary of the findings will be provided for each research paper identified. These papers provide the basis of a number of recommendations provided in the following section of this submission. Recommendations are provided throughout this report (numbered and in bold).

- Deegan, C., Gordon, B., "A Study of The Environmental Disclosure Practices of Australian Corporations", *Accounting and Business Research,* Vol 26, No. 3, Summer, 1996, pp 187 – 199. This paper demonstrated that organisations in environmentally sensitive industries (sensitivity was based on a questionnaire administered to NGOs) tend to disclose more positive (self-laudatory) information about their environmental performance than those entities in less environmentally sensitive industries.
- Deegan, C., Rankin, M., "Do Australian companies report environmental news objectively? An analysis of environmental disclosures by firms prosecuted successfully by the Environmental Protection Authority", *Accounting, Auditing and Accountability Journal,* Vol 9, No. 2, 1996, pp 50 – 67. This paper demonstrated that firms that had been successfully prosecuted for breaching particular environmental laws disclosed significantly more environmental information (of a favourable nature) in the year of prosecution than any other year in the sample period. Consistent with the view that companies increase disclosure to offset any reputational or legitimacy-threatening effects of EPA prosecutions, the EPA-prosecuted firms also disclosed more environmental information, relative to a matched sample of non-prosecuted firms. The authors concluded that the public disclosure of proven environmental prosecutions has an impact on the disclosure policies of firms involved.
- Deegan, C., Rankin, M., "The Materiality of Environmental Information to Users of Accounting Reports", *Accounting, Auditing and Accountability Journal,* Vol. 10, No. 4, 1997, pp 562 – 583. This paper demonstrated that there are various stakeholder groups who demand information about

corporate environmental performance, albeit that they question the objectivity of such information within a voluntary reporting regime.

- Deegan, C., Brown, N., "The Public Disclosure of Environmental Performance Information - A Dual Test of Media Agenda Setting Theory and Legitimacy Theory", *Accounting and Business Research*, Winter 1998, Vol 29, No. 1, pp 21 – 41. This paper undertook research to determine whether increased media attention is matched by increased corporate disclosures. The research was based on a view (provided by Media Agenda Setting Theory) that media attention impacts community concern, and companies themselves are likely to react to such concern. Brown and Deegan studied the annual report environmental-disclosure practices of companies from nine industries. Results showed that higher levels of media attention directed at the environmental consequences and performance of particular industries was generally associated with higher levels of annual-report environmental disclosures of firms within those industries.
- Deegan, C., Rankin, M., "The Environmental Reporting Expectations Gap: Australian Evidence*", British Accounting Review*, Vol. 31, No. 3, September 1999, pp. 313 – 346. The results of the research shows that users of annual reports are more likely than annual report preparers: to consider environmental information is important to their decisions than is perceived to be the case by the annual report preparers; to rank various items of social information as important, relative to annual report preparers; to disagree with a view that environmental disclosures should be voluntary, relative to annual report preparers; and, to consider that the accounting profession and government should provide environmental reporting guidelines.
- Deegan, C., Rankin, M., Voght, P., "Firms' Disclosure Reactions to Major Social Incidents: Australian Evidence", *Accounting Forum*, Special Issue on Social and Environmental Accounting, Vol. 24, No. 1, March 2000, pp. 101 – 130. This paper reviewed the annual reports of a sample of companies within the mining, oil transport and production, and chemical industries, who were considered to face threats to their legitimacy as a result of a major social or environmental incident or disaster which occurred within these industries. Corporations in the related industries were found to provide significantly greater levels of *total* and *positive* incident-related disclosures after the incident than before the incident. That is, companies appeared to change their disclosure policies around the time of major company and industry related events.
- Deegan, C., Rankin, M., Tobin, J., "An Examination of the Corporate Social and Environmental Disclosures of BHP From 1983 – 1997: A Test of Legitimacy Theory", *Accounting, Auditing & Accountability Journal*, Vol. 15, No. 3, 2002, pp. 312 - 343. This paper focused on the social and

environmental disclosure policies of BHP Ltd (now BHP Billiton) for the years 1983 to 1997. The research sought to determine whether the extent of community concern pertaining to particular social and environmental issues associated with BHP Ltd's operations (based on the extent of media attention devoted to particular issues) in turn elicits particular disclosure reactions from the company. Specifically, the underlying proposition was that changes in society concerns, reflected by changes in the themes of print media articles, will be mirrored by changes in the social and environmental themes disclosed, and by the extent of the disclosure being made. The findings show that those issues that attracted the largest amount of media attention were also those issues that were associated with the greatest amount of annual report disclosures. The results highlight the potential power of the media in influencing corporate disclosure policies, and they reinforce the dilemma that unless community concerns are somehow aroused (perhaps as a result of the media embracing a particular agenda) then managers may elect not to provide information about particular aspects of their organisation's social and environmental performance.

- Deegan, C., Blomquist, C., "Stakeholder Influence on Corporate Reporting: An exploration of the interaction between the World Wide Fund for Nature and the Australian Minerals Industry", *Accounting, Organizations, and Society,* forthcoming 2005. This paper investigated factors that appeared to motivate the minerals industry to develop a code of environmental management. In large part, the results show that the Code, which has a reporting component, was developed in response to concerns about the legitimacy of the industry.

In summarising the results of the above papers it appears that in a predominantly voluntary social and environmental reporting regime, corporations will only provide information when their legitimacy has been threatened. Overwhelmingly, disclosure appears on average to be less about an acceptance that an entity has an *accountability* for its social and environmental performance and more about *reputation management*. A quote provided in Deegan, Rankin and Tobin (2002, p. 333) usefully summarises the concerns that flow as a result of the above research. They state:

> This paper, and a number of others, have provided evidence that managers disclose information to legitimise their organisations' place within society. This paper also provides evidence consistent with a view that greater media attention stimulates greater corporate disclosure. More specifically, when there is perceived to be adverse public opinion, reporting media such as the annual report are used in an endeavour to bring public opinion back in support of the company. … A broader point we can consider is whether legitimising activities, such as those relating to

annual report disclosures, are beneficial to the community. Legitimising disclosures mean that the organisation is responding to particular concerns that have arisen in relation to their operations. The implication is that unless concerns are aroused (and importantly, the managers *perceive* the existence of such concerns) then unregulated disclosures could be quite minimal. Disclosure decisions driven by the desire to be legitimate are not the same as disclosure policies driven by a management view that the community has a *right-to-know* about certain aspects of an organisation's operations. One motivation relates to survival, whereas the other motivation relates to responsibility.

Arguably, companies that simply react to community concerns are not truly embracing a notion of accountability. Studies providing results consistent with Legitimacy Theory (and there are many of them) leave us with a view that unless specific concerns are raised then no *accountability* appears to be due. Unless community concern happens to be raised (perhaps as a result of a major social or environmental incident which attracts media attention), there will be little or no corporate disclosure…. Legitimising disclosures simply act to sustain corporate operations which are of concern to some individuals within society. To the extent that the corporate social and environmental disclosures reflect or portray management concern as well as corporate moves towards actual change, the corporate disclosures may be merely forestalling any *real* changes in corporate activities…. Legitimising disclosures are linked to corporate survival. In jurisdictions such as Australia, where there are limited regulatory requirements to provide social and environmental information, management appear to provide information when they are coerced into doing so. Conversely, where there is limited concern, there will be limited disclosures. The evidence in this paper, and elsewhere, suggests that higher levels of disclosure will only occur when community concerns are aroused, or alternatively, until such time that specific regulation is introduced to eliminate managements' disclosure discretion. However, if corporate legitimising activities are successful then perhaps public pressure for government to introduce disclosure legislation will be low and managers will be able to retain control of their social and environmental reporting practices.

The results of the multitude of research conducted into social and environmental reporting leads the author to conclude that mandatory reporting is required. In proposing that social and environmental disclosures should be regulated we necessarily raise a number of issues. Two such issues include:

- Where should mandated disclosures be made?

- What should be the focus of the disclosures?

These issues are examined below.

Where should corporate social responsibility disclosures be made?

Corporations can make environmental disclosures in various fora. They might make disclosures within their annual report, in stand-alone environmental (or triple bottom line, environment health and safety, or sustainability) reports, on websites, in leaflets dropped to local communities, in media commercials, and so forth. There are also various environmental regulations that may require disclosures to be made (for example, disclosures to be made pursuant to various environmental licensing requirements). These laws might be territory, state, or federal in focus. There is also the National Pollutant Inventory which operates at a national level and which requires certain organisations to provide information about the release or emissions of certain specified substances. There are also various Industry Codes that require signatories to periodically provide environmental performance information. There are also limited requirements within the corporations law which requires corporations to provide information about their environmental performance (for example, section 299(1)(f)).

The annual report released by corporations is an obvious vehicle for such disclosures. Evidence shows that the annual report is reviewed by various stakeholder groups and is the disclosure medium that is the most widely distributed. It is also the disclosure medium that is regulated at a national level. Disclosures, such as those made in stand-alone environmental or triple bottom line reports (or corporate social responsibility or sustainability reports as they are often called) are not subject to disclosure regulation (the disclosures are voluntary), the implication being that data being disclosed tends to be selectively disclosed, and the ability to benchmark or compare performance with other entities is limited.

Disclosures within corporate annual reports are governed by the *Corporations Act*, Accounting Standards, and Australian Stock Exchange listing requirements (for listed entities). In investigations undertaken by the Parliamentary Joint Statutory Committee on Corporations and Securities, which led to *the Corporations Amendment Bill 2002*, a view was put forward by the committee that environmental disclosure should be the subject of environmental law, rather than corporations law. However, it is far from clear which particular environmental law would be the appropriate place for corporate disclosure regulation, and further what elements of performance would be covered by Federal environmental laws as opposed to State-based environmental laws. Further, for those disclosures that might be required at a State-based level, a corporation operating across States would have a disaggregated level of performance shown by states, and there is also the problem of coordinating the disclosures of the various states. If a Commonwealth environmental law was chosen there is the possibility that it would only capture corporate activities that are deemed to relate to matters of

national environmental significance and that could mean that various other activities are ignored. For such reasons the author believes that disclosure within the annual report is appropriate, and whilst the current disclosure regime for annual reports (governed by Accounting Standards and Stock Exchange Listing Requirements) is overwhelmingly financial-performance focused, there is nothing to preclude the introduction of environmental-performance-related disclosures within these sources of regulation if a suitable case is made. The information to be included could be financial or non-financial in nature.

In relation to accounting standards, the Australian Accounting Standards Board (AASB) is responsible for developing such standards.[1] The AASB reports to the Financial Reporting Council (FRC). The FRC assumes an oversight function in regard to the AASB, and also appoints the nine part-time members of the AASB. The full time chairperson of the AASB is appointed by the Federal Treasurer. The FRC is made up of 12 people that are either appointed by the Federal Treasurer, or alternatively, the Treasurer may appoint a person by specifying an organisation or body that in turn is to choose the person who will represent them. Recently appointed members were nominated by the Australian Institute of Company Directors, Investment and Financial Services Association, Heads of States and Territories Treasury, Australian Shareholders Association, Institute of Chartered Accountants in Australia, Securities Institute of Australia, ASIC, CPA Australia, Australian Stock Exchange, the Federal Government, and the Business Council of Australia.

In considering the membership of the FRC, there is an absence of representation from groups that are *not* primarily interested in the financial performance of reporting entities, but nevertheless, might be interested in other aspects of the entities' performance. For example, there is an absence of explicit or direct representation from organisations or government departments that might be concerned with the social and environmental performance of corporations. This lack of representation is despite the fact that social and environmental performance is increasingly being linked to financial performance. This is reflective of the existing regulation in the area of corporate reporting which clearly is focussed on providing financial performance information for the use of those parties with a financial stake in corporations. With the narrow (financial) interests of the representatives on the FRC it is hardly surprising that disclosure initiatives relating to social and environmental performance and related accountability have been slow to surface. This discussion leads to the following suggestion:

RECOMMENDATION 1: Government should consider reviewing the membership of the FRC so to include representatives from stakeholder groups who

[1] According to an article in *The Age* (29 July 2005), the AASB apparently has social responsibility disclosures on its agenda – but despite a number of emails from the author of this submission to the Chairperson of the AASB, no details could be obtained.

use annual reports, but who would be able to identify stakeholder demands for social and environmental performance information to include within the annual report.

Apart from accounting standards (which are given legal standing by virtue of the *Corporations Act* and which to date have ignored social and environmental issues), the Australian Stock Exchange (ASX) has numerous rules relating to disclosures that must be followed by organisations listed on the Exchange. Whilst not specifically social or environmental in focus, some of these have general application to social and environmental-performance related issues (although decision makers within the ASX do not seem to see the significance of social and environmental issues). For example, in Chapter 3 of the Listing Rules relating to Continuous Disclosure there is the General Rule that:

> 3.1 Once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the share price or value of the entity's securities, the entity must immediately tell ASX the information.

Section 3.1 could be applied to certain social and environmentally-related events, although it does suffer from the problems associated with determining "materiality". Whether an environment issue should only be disclosed if it is likely to have a "material" impact on share price (of direct concern to shareholders) is debateable.

Chapter 4 of the Listing Rules, which relates to Periodic Disclosures, requires certain disclosures to be made within the entity's annual report. Two disclosures are of particular interest:

> 4.10.3 A statement disclosing the extent to which the entity has followed the best practice recommendations set by the ASX Corporate Governance Council during the reporting period. If the entity has not followed all of the recommendations the entity must identify those recommendations that have not been followed and give reasons for not following them.
>
> 4.10.17 A Review of Operations and Activities for the reporting period.

In principle, the recommendations of the Corporate Governance Council might have included various policies and procedures aimed at ensuring high levels of social and environmental performance. However, the current guidelines only give fairly superficial treatment to social and environmental aspects of a company's governance system. I will return to this issue later in this submission when I make recommendations relating to corporate governance-related disclosures.

In relation to the *Review of Operations and Activities* (required by 4.10.17 as indicated above), the ASX states that "the ASX does not require the review of operations and activities to follow any particular format. Nor does the ASX specify its contents. However, ASX supports the Group of 100 Incorporated publication *Guide to the Review of Operations and Financial Condition*". The ASX clearly could have made specific disclosure requirements pertaining to social and environmental performance had it wished. In relation to the Group of 100 publication, the publication provides the following recommendations:

> To meet information needs of its shareholders, capital market participants and an increasing array of other stakeholders, a company should explain its past performance and provide information that will increase understanding of future directions. This can be achieved through a Review which provides a critical and objective analysis and explanation of a company's past and likely future performance and financial condition, concentrating on the opportunities and risks associated with the past operations of the company and the opportunities and risks likely to impact on the future activities of the company. The Review should provide users with an understanding of the company by providing a short-term and long-term analysis of the business as seen through the eyes of the directors. This will be facilitated by providing useful financial and non-financial information and analysis….Information and analysis contained in the Review should be balanced and objective, free from bias and complete, dealing even-handedly with both positive and negative aspects of operations, financial condition and risks and opportunities.

The above material clearly shows that there is scope within the existing ASX Listing requirements for information to be provided within the Review of Operations and Activities about social and environmental issues associated with the operations of corporations, with specific reference to the associated risks (however, it does not appear that companies are making social and environmentally-related disclosures within their Review of Operations and Activities). The G100 publication also states:

> The Review should outline the opportunities and risks in respect of the industries and locations in which the company operates and the legal, social and political environments which affect the company and its activities. The Review should deal with changes in these industries, locations or environments, as well as changes in the company, and their effects on the results of operations and the financial condition of the company. Clear quantitative and qualitative goals, milestones or benchmarks may assist in explaining the overall corporate objectives….Where practical, KPIs should be linked to and be identified with the key business

> objectives, be compared with other periods to outline trends and should include multiple perspectives such as sustainability measures including social and environmental performance measures, where relevant….The principal opportunities, risks and threats in the main lines of business that pervade a company's competitive landscape, together with a commentary on the approach to managing those opportunities and risks and, in qualitative terms, the nature of the potential impact on strategies and results, should be clearly communicated.

The above recommendations make explicit reference to environmental performance measures. However, it is emphasised that these are recommendations of G100 and compliance with ASX Listing Rules does not necessarily require disclosure of environmental performance information. Unfortunately such disclosures are still voluntary.

In 2003, G100 also released a report entitled *Sustainability: A Guide to Triple Bottom Line Reporting*. Within the report, G100 emphasises the importance of environmental and triple bottom line reporting. On page 16 of the report they state:

> In addition to the benefits obtained through superior relationships with key stakeholder groups, the decision to be publicly accountable for environmental and social performance is often recognised as a powerful driver of internal behavioural change. The availability of relevant information on economic, environmental and social performance that previously may not have been collected and evaluated in a readily understood manner may enable executives to identify and focus attention on specific aspects of corporate performance where improvement is required.

In the Foreword to the G100 report the President of the Business Council of Australia states:

> Triple bottom line reporting therefore ties in with one of the greatest challenges currently facing the corporate sector – our reputation in the community. The Australian community has a low opinion of big business. Big business is seen as anonymous, detached from the community, self interested and greedy. At the same time, the broader community expects big business to deliver on a lot more than just jobs and profits. We are expected to set a higher ethical standard and help build a better society for all.

Whilst comments such as those provided above could be construed as providing weight for any calls to mandate corporate social and environmental reporting, it is interesting to note that both the G100 and Business Council of Australia have

actively lobbied government to ensure that social and environmental reporting remains predominantly voluntary. Hence, whilst they appear to believe social and environmental reporting is important, they as groups consider that social and environmental disclosures are best left to the discretion of reporting companies. The above discussion leads to the following recommendation:

RECOMMENDATION 2: The ASX should give consideration to requiring that the disclosures made within the Operating and Financial Review specifically make reference to opportunities, risks and threats to the business that relate to the organisation's environmental performance.

In the UK recently there have been developments related to the disclosures corporations made within their Operating and Financial Review (the requirement to provide a OFR is a corporations law requirement, rather than a stock exchange requirement, within the UK). According to Environment Agency (UK), 2002:

> Directors preparing an OFR will need to consider many factors including, as a first among equals, their company's impact on the environment…. In deciding what other issues they need to report on, directors will need to consider a whole range of factors within and outside the company including employee and business relationships and regard for the company's impact on communities. However, the White Paper (Modernising Company Law White Paper, released by the Department for Trade and Industry) also makes clear that Government believes every director needs to consider environmental issues as one, if not the most, important factor.

Within the UK, the financial statement auditor is to report to the members of the company on the OFR in terms of whether the company has followed 'appropriate procedures' and whether the contents of the OFR is consistent with the information the auditors have gained in the course of their financial audit.

By way of comparison, in the United States, the Securities and Exchange Commission (SEC) has incorporated environmental disclosure requirements within its Listing Requirements. Within the main set of rules governing the disclosures to be made by US companies (Regulation S-K) there is a requirement that:

> Appropriate disclosure also shall be made as to the material effects that compliance with Federal, State and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have upon the capital expenditures, earnings and competitive position of the registrant and its

> subsidiaries. The registrant shall disclose any material estimated capital expenditures for environmental control facilities for the remainder of its current fiscal year and its succeeding fiscal year and for such further periods as the registrant may deem material.

To further strengthen this reporting requirement, the SEC has a joint agreement with the US Environmental Protection Agency (EPA) in which the SEC is provided with information from the EPA of:

- companies identified as potentially responsible parties on hazardous waste sites;
- companies subject to clean-up requirements under the *Resource Conservation and Recovery Act*;
- companies named in criminal and civil proceedings under environmental laws.

The SEC uses this information to review disclosures being made by corporations to the Exchange. Such linkages between the stock exchange and environmental regulators do not exist within Australia – though arguably they could. However, a downside of the US requirements is that like the Australian position, disclosure is required where it is likely to have a 'material effect' on share prices. As Claros Consulting (2003, p. 34) states:

> Much of the debate in the US is over the issue of materiality. Companies only have to report if a particular impact is 'material', which is typically taken to mean as greater that 5% of net assets. Despite SEC guidance that the qualitative information can be material, companies find it easy to use 'materiality' to limit disclosure of information on environmental and social factors. This is compounded by the fact that the US case law has made it clear that in the absence of a specific regulation to disclose defined information, it is difficult to press companies to disclose using general principles.

The above discussion leads to the following recommendation:

RECOMMENDATION 3: The ASX consider the possibility of forming links with State, Territory and or Federal environment agencies with the view towards ensuring that companies are properly disclosing information about environmental liabilities associated with their operations.

Related to the above discussion, it should also be noted that at the current time it is extremely difficult for interested parties to gather information about contaminated sites. Companies frequently provide no information about such sites, or the related obligations within their annual reports.

The Global Reporting Initiative's (GRI) *Sustainability Reporting Guidelines* could be used as a basis for mandatory reporting if mandatory social and environmental (and sustainability) reporting was to be introduced within a particular jurisdiction. For example, the *King Report on Corporate Governance for South Africa,* which was endorsed in 2002 by the Johannesburg Stock Exchange, makes reference to the GRI Guidelines.

If we consider existing mandatory corporate reporting frameworks as constituted by accounting standards, corporations law reporting requirements, and stock exchange reporting requirements (as previously discussed) it would appear to be the case that external reporting requirements have predominantly focussed on providing financial performance information to those parties with a financial stake in the corporation. Even the most recent developments in disclosure requirements pertaining to corporate governance issues (for example the *ASX Corporate Governance Council Principles of Good Corporate Governance and Best Practice Recommendations*, 2003) have tended to focus on the information needs of shareholders, rather than taking a broader 'stakeholder' perspective. Such an approach is commonly referred to as a 'shareholder primacy' view to corporate reporting. At this stage however, government has tended to leave corporations, their industry bodies, and 'the market' to determine the extent of corporate social and environmental disclosure. This is evidenced by the very limited disclosure requirements pertaining to non-financial performance issues associated with social and environmental issues. In this regard, Frank Cicutto, former Chief Executive Officer of National Australia Bank stated[2]:

> In recent decades the efficient use of shareholder funds has been carefully protected by the creation of ASIC and the continuing development of the ASX listing rules. In a regulatory sense the focus of legislative change has been around accountability to investors rather than to the community.

Having made some broad comments about the possible sources of disclosure – these being within accounting standards, *The Corporations Act*, or within ASX requirements - we will now consider more specific recommendations about the focus of disclosures. It is the author's opinion that to assess an entity's social and environmental risks, we need information about the corporate governance structures in place as they pertain to improving or controlling social and environmental performance. As such, the following disclosure recommendations are largely related to corporate governance policies.

[2] As quoted in the Journal of Banking and Financial Services, December 2002, p.17.

Some specific items for disclosure

Where (unregulated) corporate environmental disclosures are currently being made they typically relate more to outcomes (for example, emission levels) than to processes. However, if a report reader was trying to assess the future performance and risk of an organisation as it relates to social and environmental performance they really need to know about the existence of governance structures aimed at maintaining and improving social and environmental performance (or as importantly, they need information about the absence of social and environment-related governance structures). Such governance systems might include, for example:

- Social and environmental policies;
- Stakeholder engagement policies and committees;
- Remuneration policies tying rewards to social and environmental performance;
- Supplier policies;
- Overseas operating policies;
- Environmental audit policies;
- Environmental management systems; and
- Environment committees.

If the requisite corporate governance structures are not well developed then it will be extremely difficult for corporations to improve their social and environmental performance through other *ad hoc* methods and approaches.

In 2003 the ASX Corporate Governance Council released its *Principles of Good Corporate Governance and Best Practice Recommendations*. As the document states (p.5), pursuant to ASX Listing Rule 4.10, companies are required to provide a statement in their annual report disclosing the extent to which they have followed the best practice recommendations in the reporting period. Where companies have not followed all the recommendations, they must identify the recommendations that have not been followed, and give reasons for not following them.

Like the ASX Listing rules themselves, the Corporate Governance Guidelines appear to embrace a *stakeholder primacy* view towards reporting. On page 15 of the Guidelines, when discussing the roles and responsibilities of board and management, the Guidelines state the company's framework should be designed to "clarify the respective roles and responsibilities of board members and senior executives in order to facilitate board and management accountability to both the company and its shareholders". The document seems to miss the very important point that corporations have an accountability to *other stakeholders* as well. Principle 3 of the Guidelines (there are 10 Principles in total) is "Promote ethical and responsible decision-making". No mention is made within the material that accompanies this Principle of social or environmental responsibilities.

Principle 5 of the Guidelines is “Make timely and balanced disclosure”. In the discussion relating to this principle, it is stated that the company must put in place mechanisms to ensure “all investors have equal and timely access to material information concerning the company – including its financial situation, performance and governance”. Apart from relying upon the problematic notion of ‘materiality’, there again appears to be a fixation on financial performance issues to the exclusion of social and environmental issues.

Principle 6 is “Respect the rights of shareholders” – there is no similar principle in relation to other stakeholders. Principle 7 is “Recognise and manage risk” – there is no explicit mention associated with the risks that poor social and environmental performance might cause for a company.

Principle 9 is “Remunerate fairly and responsibly”. Whilst the discussion does call for a remuneration policy that “motivates directors and management to pursue the long-term growth and success of the company” there is nothing about how remuneration policies should also reflect the social and environmental policies of the companies involved.

Principle 10 is “Recognise the legitimate interests of stakeholders”. This is the only Principle that extends the accountability of an organisation beyond maximising financial performance for the benefits of shareholders. Whilst no mention is made of the environment, some limited attention is given to employment and community practices.

In many respects, the Corporate Governance Council’s recommendations represent a lost opportunity. Rather than maintaining the focus of the pre-existing rules on financial performance issues, this document provided a potential avenue to address environmental and social issues – both of which represent crucial issues to corporate success. Further, because of the general lack of guidance and disclosure in the corporate governance area as it pertains to social and environmental governance policies, the Guidelines provided a potential platform for introducing disclosures which are important to corporate stakeholders and which would have placed the Australian financial market at a competitive advantage. This advantage was lost.

By way of international comparison, the final *King Report on Corporate Governance* was released in South Africa in 2002. It made corporate governance recommendations relating to numerous issues, including social and environmental issues. It was endorsed by the Johannesburg Stock Exchange and incorporated within its listing rules, effective from March 2002. There is a component of the requirements, referred to as *Integrated Sustainability Reporting*, that requires that:

> every company should report at least annually on the nature and extent of its social, transformation, ethical, safety, health and environmental management policies and practices. The board must determine what is relevant for disclosure, having regard to the company's particular circumstances.

The disclosure requirements make reference to the GRI *Sustainability Reporting Guidelines* as a useful source of guidance. Apart from referring to the GRI Guidelines, the disclosure requirements also require specific disclosure of a number of other social and environmental items, including environmental governance, including use of 'Best Practicable Environmental Option standard'.[3] The actions of the Johannesburg Stock Exchange represented a 'leading-edge' position. As Claros Consulting (2003, p. 33) states:

> The King Report represents a landmark in official recognition of the importance of social and environmental reporting. It is the first time that social and environmental reporting has been backed by an official code on corporate governance for companies, with the support of business, financial institutions and government. It achieves a good balance between ensuring meaningful disclosure and avoiding being too burdensome or complex. It would not be overstating the case to say it gives South Africa and the Johannesburg Stock Exchange a leadership position when it comes to integrating sustainability into financial institutions.

The above discussion leads to the following recommendation:

RECOMMENDATION 4: As a broad level recommendation, the ASX Corporate Governance Council should consider making explicit recommendations about particular corporate governance requirements as they relate to sound social and environmental performance.

The Principles developed by the ASX Corporate Governance Council would be expected to be reflective of the membership of the Council. The membership of the Council is shown below

- Association of Superannuation Funds of Australia Ltd;
- Australasian Investor Relations Association;
- Australian Council of Superannuation Investors;
- Australian Institute of Company Directors;
- Australian Institute of Superannuation Trustees;
- Australian Shareholders' Association;

[3] Best Practicable Environmental Option standard is defined as the option that has the most benefit, or causes the least damage, to the environment at a cost acceptable to society.

- Australian Stock Exchange Limited;
- Business Council of Australia;
- Chartered Secretaries Australia;
- CPA Australia;
- Group of 100;
- Institute of Actuaries of Australia;
- Institute of Chartered Accountants in Australia;
- Institute of Internal Auditors Australia;
- International Banks and Securities Association of Australia;
- Investment and Financial Services Association;
- Law Council of Australia;
- National Institute of Accountants;
- Property Council of Australia;
- Securities & Derivatives Industry Association; and
- Securities Institute of Australia.

As with the Financial Reporting Council (previously discussed), if we look at the council members we see that there are no members who specifically work with an organisation that has a social or environmental responsibility. Again their appears to be an element of regulatory capture in which business organisations or parties with a financial focus dominate corporate disclosure development. Parties with expertise in social and environmental performance and accountability issues would have valuable expertise and insights into appropriate governance structures aimed towards improving corporate social and environmental performance. The current structure of the Council leads to the following recommendation:

RECOMMENDATION 5: That the ASX consider admitting to Council representatives from government or non-government organisations that are directly concerned with environmental-performance and social-performance matters.

In relation to specific disclosure recommendations, the discussion below identifies a number of possible disclosures relating to corporate governance systems. At this point it should be noted that the GRI Sustainability Reporting Guidelines have a number of recommendations in relation to 'Structure and Governance'. The recommendations seem very valid. However, evidence indicates that very few organisations are actually providing the information suggested by the recommendations – perhaps reinforcing the need for some form of 'regulatory stimulus' within Australia (potentially through ASX disclosure requirements or through accounting standards).

In terms of the recommended disclosures, we can first consider the role of boards of directors. The boards of directors are responsible for making strategic business

decisions. Interested stakeholders would most likely want to be informed as to how environmental issues are factored into Board decision-making.

RECOMMENDATION 6: With regard to the board, the company should state in its annual report whether:

- ***The Board takes regular account of the significance of social, environmental and ethical (SEE) matters to the business of the company.***
- ***The Board has identified and assessed the significant risks to the company's short and long term value arising from SEE matters, as well as the opportunities to enhance value that may arise from an appropriate response.***
- ***The Board has received adequate information to make this assessment and that account is taken of SEE matters in the training of directors.***
- ***The Board has ensured that the company has in place effective systems for managing significant risks, which, where relevant, incorporate performance management systems and appropriate remuneration incentives.***[4]

Further, at a more specific level:

RECOMMENDATION 7: With regard to policies, procedures and verification, the annual report should:

- ***Include information on SEE-related risks and opportunities that may significantly affect the company's short and long term value, and how they might impact on the business.***
- ***Describe the company's policies and procedures for managing risks to short and long term value arising from SEE matters. If the annual report and accounts states that the company has no such policies and procedures, the Board should provide reasons for their absence.***
- ***Include information about the extent to which the company has complied with its policies and procedures for managing risks arising from SEE matters.***
- ***Describe the procedures for verification of SEE disclosures. The verification procedure should be such as to achieve a reasonable level of credibility.***[5]

In relation to the above disclosure recommendations and those recommendations that follow, such disclosures could be embraced either within the Corporations Act, or they could be restricted to listed companies by means of amendments to the ASX Listing Requirements.

Arguably, changes in the corporation's risk environment since the previous period should be brought to the attention of interested stakeholders.

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[4] These recommendations have been quoted directly from the *Association of British Insurers: Disclosure Guidelines on Socially-Responsible Investment.*

[5] These recommendations have been quoted directly from the *Association of British Insurers: Disclosure Guidelines on Socially-Responsible Investment.*

RECOMMENDATION 8: The directors need to explicitly identify and disclose changes in corporate risks that have occurred since the previous financial period, as they pertain to environmental issues

Given the growing importance of climate change issues to business, specific disclosures relating to consideration of climate change should be provided (although it is appreciated that they could be captured by the suggestions provided above). As Ernst and Young (2003, p. 31) stated:

> Given the potential for a carbon-constrained global economy, financiers and shareholders are becoming more interested in understanding how certain sectors, such as energy exporting companies, might be exposed to regulation in offshore markets. Publicly listed Australian companies operating in such markets might also be required in the future to publicly disclose to the market how they are potentially exposed or if they are managing carbon risk …. The outcomes of the consultation and the findings of other research such as the CDP (Carbon Disclosure Project, Innovest 2003) suggest that the finance sector's high level interest in carbon risk and climate change issues will continue to develop as both a risk and commercial leveraging opportunity for finance sector participants in the medium to long term.

RECOMMENDATION 9: Corporations should disclose within the annual report whether directors or other senior management undertake a thorough assessment of the company's current and probable risk exposure to the financial and competitive consequences of climate change. As a first step, this will involve measuring the company's greenhouse gas emissions throughout the entire value chain.[6]

Accepting that employees are motivated by the financial rewards they receive from their employers, it is important to link financial rewards to relevant social and environmental performance indicators. Knowledge of this linkage would be beneficial to readers of annual reports.

RECOMMENDATION 10: Corporations should disclose within the annual report whether financial rewards paid to senior executives are in part linked to environmental performance (including performance indicators relating to climate

[6] These recommendations have been quoted directly from CERES (2002). According to CERES, the best available reporting framework with which to do this is the Greenhouse Gas Reporting Protocol. The Protocol was jointly convened by the World Resources Institute and the World Business Council for Sustainable Development, and is included in the Global Reporting Initiative Guidelines. In Australia, the Australian Greenhouse Office methodology for calculating emissions is slightly different. Information about the AGO approach can be found in the Greenhouse Challenge workbook at www.greenhouse.gov.au/challenge/tools/workbook.

change) indicators, and provide relevant disclosure to the extent this governance measure exists, or otherwise.

Because many entities have been severely criticised, and financially impacted, by various groups of stakeholders because the entities have not used best practice environmental procedures in all jurisdictions, the following requirement seems relevant:

RECOMMENDATION 11: Corporations should disclose within the annual report whether they have put in place procedures to ensure that they use consistent best environmental practice in all countries in which they operate.

It is important that local communities have an ability to be involved in activities that impact their livelihood and environment. This in itself is acknowledged by many senior corporate executives. Local communities are also able to identify particular attributes or aspects of their local environment that are deemed to be of particular value or relevance. Hence, consistent with section 2(b) of *Part V, Environment* of the *OECD Guidelines for Multinational Enterprises* (2000), the following recommendation is made:

RECOMMENDATION 12: Corporations should disclose within the annual report whether they have policies that ensure that they engage in adequate and timely communication and consultation with the communities directly affected by the environmental policies of the enterprise, and by their implementation.

In an earlier part of this report we discussed a number of issues associated with corporations signing to various industry codes. Where corporations sign to codes that in themselves have various environment-related operating and verification requirements, then this in itself would be information that various stakeholders would find potentially useful.

RECOMMENDATION 13: Corporations should disclose within the annual report whether they have committed to particular environmental management codes, and if so, what mechanisms they have to verify compliance with the code's requirements.

The Environment Agency UK (2002) has also made a number of suggestions about the types of environmental disclosures corporations should be required to make. For example, they state:

> We would recommend that new company law should require both small and large companies to account for and report to a minimum standard the following - the volume of raw materials, water and energy used, plus waste and emissions

produced. This would help reduce waste production and pollution, and increase their productivity, resource efficiency, competitiveness and profitability. This would also help the Government achieve other wider sustainable development policy and economic objectives.

Such recommendations above (and a number of others made by the Environment Agency) are covered by the GRI Sustainability Reporting Guidelines relating to the 'environment'. This of course raises the issue of whether we should recommend that the GRI Guidelines be somehow mandated within Australia. Whilst there would be many advocates for this position, at this stage I would not make such a recommendation. The above quote from the Environment Agency can also lead us to consider the issue as to which companies (for example, *small* versus *large* proprietary companies, *listed* versus *unlisted* companies) should be covered by suggested disclosure requirements. This in itself is influenced by the available regulatory mechanisms.

As we are aware, the ASX Corporate Governance Council has already developed a best-practice guide. Given this vehicle already exists then it would make sense to use it rather than seek another regulatory mechanism. Therefore I would argue that the ASX Corporate Governance Council should consider including a number of the above recommendations in the next version of its Guidelines. This would obviously require a restructuring of the Guidelines and hopefully the inclusion of additional Council members who have expertise in issues associated with social and environment performance – something that appears to be missing at present.

As we have already mentioned, there is also the Review of Operations and Activities that corporations must include in their annual report by virtue of the ASX Listing Rules. This Review could incorporate a number of the suggestions provided above.[7]

Given existing mechanisms, it would appear that the ASX Listing Rules are the most logical place to implement some of the above recommendations. This obviously means that related reporting requirements would only relate to listed entities. Whilst other entities also have an accountability for their social and environmental performance, restricting the changes to listed entities would be a reasonable progression in the first instance. It should be emphasised that such changes to the listing rules in themselves could actually be very beneficial to Australian business. As Claros Consulting (2003) stated in relation to environmental disclosure recommendations in the UK:

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[7] As indicated earlier in this report, within the UK there is also a requirement to present a Review of Operations, but by contrast, this is a company law requirement in the UK, rather than a stock exchange listing requirement.

> The financial markets are changing. Environmental, social and ethical issues are becoming increasingly more important to investors, for a variety of reasons. Yet in the UK the Listing Rules have not evolved to take account of these trends. While they do a good job at consolidating the financial experience of the investors in previous decades, they do not expressly address many current environmental and social risks and do not look forward to the needs of investors in the future. It is time to update the Listing Rules to include explicit and detailed disclosure requirements on social and environmental issues. Far from such action being a threat to the UK as a financial centre, the opposite is likely to be the case. In the wake of the scandals concerning companies such as Enron, investors will be looking for high standards of disclosure. In traditional financial terms the UK has had these for some years. Now is the time to expand this to other factors that can affect the business, and especially the fundamental issue of business sustainability. When the Pension Disclosure Regulation was announced, the UK gained a reputation as being at the forefront of integrating sustainability and investment. Recently, this leadership has looked increasingly at risk as other countries have leapfrogged the UK with stronger regulations and innovations, most notably South Africa and the *King Repor*t, which shows how sustainability can be integrated into corporate governance in the 21 st century. There is now a real chance to regain this leadership and make the UK the leading centre of sustainable international finance.

A similar case could be made within Australia.

Concluding comments

Research evidence shows that corporate social responsibility disclosures are reactive to community concerns rather than being tied to broader notions of *accountability* or *rights-to-know*. As such, it appears that there is a case for mandatory disclosure – something that business organisations have (perhaps somewhat predictably) opposed. Disclosures could be mandated within *The Corporations Act*, accounting standards, or ASX disclosure requirements. That is, the existing disclosure structures could be utilised for social and environmental disclosures. Those in charge of regulating corporate disclosures have elected to focus on financial performance rather than broader performance reflecting an apparent view that the accountability of business entities does not extent beyond financial accountability to shareholders. This view is clearly outdated. In part this approach to disclosure regulation is due to the membership of the respective regulatory bodies – most of which have backgrounds directly tied to financial performance.

It is the author's view that there would be value in focusing the disclosures on the governance structure that have (or have not) been put in place to improve corporate social and environmental performance. Suggested disclosures have been provided throughout this submission. It is also the author's view that a significant overhaul is

necessary in Australian corporate disclosure regulations. Acceptance that the community has a right to be informed about various aspects of a corporation' s social and environmental performance seems long overdue.

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