CHAPTER 6

SUSTAINABILITY REPORTING: BACKGROUND AND CURRENT STATUS

6.1 Term of reference (f) for this inquiry requires the committee to consider 'the appropriateness of reporting requirements associated with these issues.'

6.2 Sustainability reporting refers to the practice of corporations and other organisations measuring and publicly reporting on their economic, social and environmental performance. The sustainability performance information may be presented as part of an organisation's annual report, or in a stand alone report such as a sustainability report, a triple bottom line report, or an environmental or social impact report. It is one of the key ways in which companies demonstrate, and are being judged on, their commitment to corporate responsibility.

6.3 Sustainability reporting emerged as a significant issue in this inquiry, and a great deal of evidence was received by the committee on the subject. In particular, many participants expressed support for a reporting solution as the preferred way of encouraging corporate responsibility among Australian companies.[1]

6.4 This chapter provides a background to the debate on sustainability reporting and addresses:

- The benefits of, and impediments to sustainability reporting;
- The principles that should underpin sustainability reporting;
- The current status of sustainability reporting in Australia; and
- Overseas developments in sustainability reporting.

6.5 The following chapter will go on to address the current requirements for reporting in Australia, either under legislation, or by the market.

Benefits and impediments

6.6 In Australia sustainability reporting is voluntary. Companies which choose to prepare sustainability reports do so for a range of reasons including:

- informing non-shareholder stakeholders (such as employees and customers) about the societal and environmental impacts of a company's performance and the strategies in place or being developed to improve such impacts;

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1 For example, Mr Jeremy Cooper, Deputy Chairman, Australian Securities and Investments Commission, *Committee Hansard,* 29 March 2006, p. 11.

- assisting shareholders, investors and the market to determine how well companies are dealing with material non-financial and financial risks; and
- enabling companies to:
    - identify areas of operational or management improvement;
    - identify and better manage their non-financial risks;
    - identify new markets or business opportunities;
    - benchmark their performance against their competitors;
    - improve their reputation; and
    - recruit and retain high calibre staff.

6.7 According to Certified Practicing Accountants Australia's (CPA Australia) report *Sustainability – Practice, Performance and Potential*, there is a strong correlation between sustainability reporting and low probability of corporate distress. CPA Australia submitted that:

> This relationship may suggest companies that issue sustainability reports are more aware of the wider range of risks that may impact on the business and also further demonstrates that the longer term and more holistic approach to enterprise risk managements rewards both shareholders and stakeholders.[2]

6.8 Sustainability reports are prepared to convey non-financial information to a number of company stakeholders. According to the Centre for Australian Ethical Research's recent survey on sustainability reporting the main target audience for sustainability reports are employees (87%); customers (79%); shareholders (74%); local community (67%); institutional investors (54%); suppliers (59%); analysts (51%) and governments and NGOs (28%).[3]

6.9 The major impediment to the uptake of sustainability reporting is the cost and resources associated with their preparation. In its submission, KPMG cited research it undertook with the Centre for Australian Ethical Research, entitled *State of Sustainability Reporting in Australia 2005* (the CAER report), which shows that 78 per cent of respondents thought that cost and resource constraints were a barrier to sustainability reporting.[4] Wesfarmers for example quoted a figure of around $150,000, which includes printing and auditing but excludes the cost of staff time.[5]

2 CPA Australia, *Submission 103*, p. 4.

3 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 31.

4 KPMG, *Submission 53*, p. 3.

5 Mr Keith Kessell, Executive General Manager, Corporate Affairs, Wesfarmers Ltd, *Committee Hansard*, 20 February 2006, p. 42.

6.10 It is worth noting that there is a significant initial hurdle for a corporation to commence sustainability reporting. The complexities of introducing a new and unfamiliar reporting regime may be an insurmountable upfront hurdle for some organisations. The initial set up costs involved with selecting a framework and establishing appropriate information channels within the organisation are likely to be one-off costs in year one. In subsequent years, the cost and resources required to prepare a sustainability report are likely to diminish significantly as organisations are be able to use results from previous years as a starting point (and ask what has changed) and as employees become familiar with the preferred framework and type of information required. In recognition of the high initial cost burden of sustainability reporting, the committee makes a recommendation in chapter 8 that the Australian Government should examine the feasibility of introducing inflated write-off arrangements for the year-one costs of producing sustainability reports.

6.11 Based on his experience in dealing with companies involved in the Corporate Responsibility Index, the first-year hurdle problem was described well by Dr Longstaff of the St James Ethics Centre:

> The major reason, we are told, is to do with a resource constraint within companies in the first year in which they do this. It is not actually doing it [the CSR activity]; it is the data assembly which is costly and time consuming. ...
>
> The good thing about it is that, under the [Corporate Responsibility Index] process, in year 2, year 3 and subsequently, it is also possible to reduce all of that work by around two-thirds, as we have been told by companies that have been doing this for a while, because the data from one year to another are rolled over on the system. Then you only have to deal with any material change that takes place within the index as a result of changes that we put through as a result of a consultative process involving NGOs and business and flowing through with our partners in the UK and Japan.
>
> So it becomes sustainable after that, but it is that first-year hurdle...[6]

6.12 Evidence put before the committee also shows that there is a range of benefits and impediments to the independent verification of sustainability reports. The practice of auditing sustainability reports is seen to enhance a report's credibility, and provide more reliable information, while adding an additional cost burden to the process. There is also a concern that there are a limited number of credible, professional, specialist companies available to conduct an independent audit.

Principles of sustainability reporting

6.13 From the evidence presented to the committee, several common themes emerged regarding the principles that should underlie sustainability reporting. This section discusses these principles in turn.

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6 Dr Simon Longstaff, Executive Director, St James Ethics Centre, *Committee Hansard*, 23 November 2005, p. 24.

Voluntary or mandatory

6.14 In Australia, sustainability reporting is voluntary. Both Commonwealth and state/territory legislation covers aspects of relevance to corporate responsibility such as environmental and health and safety issues. However such legislation only covers specific subject matter and does not constitute a sustainability reporting framework.

6.15 Evidence to the committee indicated that those corporations and industry associations that supported the continuation of voluntary sustainability reporting did so for two main reasons: mandatory reporting would impose additional costs on business and it would lead to a compliance mentality.

Additional cost

6.16 Mr Sheehy of Chartered Secretaries Australia (CSA) stated that mandatory reporting would add a significant layer of additional compliance costs to the operations of the majority of Australian companies. Mr Sheehy went on to give an example of the cost implications of such mandatory regulation:

> We have surveyed our members from time to time. ... The number that was bandied around was $50,000 just to meet the ASX Corporate Governance Council's guidelines. For smaller organisations that is a significant cost. The cost of meeting compliance requirements is high and is always increasing.[7]

Compliance mentality

6.17 CSA also outlined the problems associated with organisations adopting a compliance mentality:

> mandating has the usual catchphrase of a 'tick the box' and we would prefer that companies arrive at the conclusion that there is value for them in adopting reporting against these sorts of things. Even with the [ASX] Corporate Governance Council guidelines ... there were a number of companies that changed their practices against their best interests because they just did not want to put up with the flak of explaining why they had not done so. That is a dangerous development.[8]

6.18 Several submitters, whilst suggesting that the current reporting sustainability requirements are insufficient for a variety of reasons, were still of the view that it is too early to introduce a mandatory requirement. For example, Corporate ResponseAbility submitted 'at this stage, it would be premature to require mandatory

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7 Mr Tim Sheehy, Chief Executive, Chartered Secretaries Australia, *Committee Hansard*, 23 November 2005, p. 42.

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

reporting by Australian listed companies as the appropriate accounting and auditing procedures are still in development.'[9]

6.19 Submitters that supported the introduction of mandatory sustainability reporting did so for three main reasons: improved management of non-financial risks, investor's ability to value non-financial risks properly, and greater accountability and transparency. Several investment organisations supported a minimalist form of mandatory sustainability reporting, limited to just a few key performance indicators. These submissions are discussed in chapter 7.

Management of non-financial risks

6.20 This rationale was effectively described by Dr Black, who gave evidence that:

> ...mandatory reporting benefits many stakeholders but most particularly the corporations themselves. ... The corporations benefit because it requires them to establish systems and structures for understanding and addressing their broad ranging impacts and it can help them to better manage new types of risk that they may not previously have addressed.[10]

Valuing non-financial risks

6.21 This argument is reminiscent of the main justification of mandatory financial disclosure requirements – to protect investors.[11] Dr Black described how mandatory sustainability reporting allows institutional investors to get a better overall picture of company value by having access to information on non-financial risks. She said:

> Investors benefit because they have better quality information on corporate value drivers with which to make investment decisions and that benefits a huge number of Australians because we have so much invested in compulsory superannuation.[12]

Accountability and transparency

6.22 Several submitters suggested that there is a need for mandatory sustainability disclosures to give stakeholders confidence that companies are operating accountably and transparently. For example Mr Masson of the Finance Sector Union stated:

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9 Corporate ResponseAbility, *Submission 93*, p. 8. However, the submission went onto say 'it is reasonable for all listed ASX 100 companies to be encouraged to produce their first CSR report by 2007, and all ASX 200 companies by 2009.'

10 Dr Leeora Black, Managing Director, Australian Centre for Corporate Social Responsibility, *Committee Hansard*, p. 102.

11 R. P. Austin, & I. M. Ramsay, *Ford's Principles of Corporations Law*, 12th Edition, Sydney, 2005, p. 499.

12 Dr Leeora Black, Managing Director, Australian Centre for Corporate Social Responsibility, *Committee Hansard*, 24 February 2006, p. 102.

> I would like to see those players that currently ignore CSR come up to the standard, even if it is a minimum, because it will be something against which we can hold them to account.[13]

6.23 Mr Ensor of Oxfam Australia suggested that:

> ...mandatory mechanisms are required to ensure that Australian companies are socially and environmentally responsible, transparent and accountable to their stakeholders.[14]

6.24 Dr Anderson of Monash University gave a somewhat frank account of the accountability argument:

> ...mandatory reporting ... makes [companies] disclose exactly what they are doing and therefore they will fear how the community judges them and they will clean up their act ... Maybe you do not need to change the directors' duty section if you totally expose what they really do. That would support the mandatory introduction of the reporting.[15]

Cost-effective

6.25 Throughout the inquiry the high and at times prohibitive cost of preparing sustainability reports was identified as a major impediment to its increased uptake. The CAER report indicated that 'for the last three years [2003–2005] companies have been consistent in their identification of cost and resource constraints as the key impediment to sustainability reporting.'[16] It went on to recommend that 'initiatives be developed that will reduce the cost of sustainability reporting, and that such initiatives should remain consistent with the GRI.'[17]

6.26 A representative of the Department of the Environment and Heritage (DEH) gave evidence that cost-effectiveness was one of the key considerations in Senator Campbell's reference to the ASX Corporate Governance Council (discussed in chapter 7). He stated: 'what is being looked at is a consistent framework which works for Australia and which provides the comparability and cost-effectiveness'.[18]

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13 Mr Rod, Masson, Manager, Policy and Communications, Finance Sector Union, *Committee Hansard*, 23 February 2006, p. 42.

14 Mr James Ensor, Director, Public Policy and Outreach, Oxfam Australia, *Committee Hansard*, 24 February 2006, p. 19.

15 Dr Helen Anderson, Acting Head of Department, Department of Business Law and Taxation, Monash University, *Committee Hansard*, 24 February 2006, p. 71.

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

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

18 Mr Gene McGlynn, Assistant Secretary, Department of the Environment and Heritage, *Committee Hansard*, 27 March 2006, p. 30.

6.27 The principle of cost-effectiveness is particularly important in relation to small to medium enterprises. These companies will typically have a lower degree of social and environmental impact than their larger counterparts and also a lesser capacity to meet the costs of reporting. In this regard, the formulation used in the *EU Accounts Modernisation Directive* (discussed below) is worth mentioning. The Directive requires the disclosure of non-financial information 'in a manner consistent with the size and complexity of the business'.[19]

Flexibility

6.28 To meet the diverse needs of Australia's business community, flexibility was recognised as a key principle of sustainability reporting. Mr Matheson of the Australian Investor Relations Association encapsulated the essence of the notion saying 'an approach that provides flexibility ... to listed entities to consider and then disclose that sustainability or non-financial information that is pertinent to the company and its stakeholders is the preferred approach.'[20]

6.29 The ASX Corporate Governance Council's *Principles of Good Corporate Governance and Best Practice Recommendations* (ASX Council Recommendations) provide a good example of a flexible approach. The ASX Council Recommendations, which were outlined in chapter 2 of this report, state:

> The size, complexity and operations of companies differ, and so flexibility must be allowed in the structures adopted to optimise individual performance. That flexibility must, however, be tempered by accountability – the obligation to explain to investors why an alternative approach is adopted – the 'if not, why not' obligation.[21]

6.30 The 'if not, why not' construction was seen favourably by submitters such as the Australian Institute of Company Directors which submitted 'the flexibility of the ASX Principles' 'if not, why not' approach is preferable and achieves the goal of enhanced disclosure without stifling flexibility...'[22]

Comparability

6.31 The lack of comparability of non-financial information was seen by many submitters as a key deficiency in current sustainability reporting practices in Australia. The DEH noted 'there is a strong view in the community that inconsistency in [sustainability] reporting is limiting the maximising of the benefits that reporting can

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19 Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003, Official Journal of the European Union, 17 July 2003, p. L178/17.

20 Mr Ian Matheson, Chief Executive Officer, Australian Investor Relations Association, *Committee Hansard*, 27 March 2006, p. 2.

21 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, foreword.

22 Australian Institute of Company Directors, *Submission 73*, p. 18.

deliver.'[23] Two other government agencies, the Treasury and ASIC, expressly recognised that sustainability disclosures should be readily comparable.[24]

6.32 The level of inconsistency apparent in current reporting practices was aptly described by Mr Cohn of RepuTex:

> ...at the moment there is a large degree of disparity between the different sorts of sustainability or social responsibility or triple bottom-line reports that are produced. Some focus almost exclusively on charitable donations or philanthropic activities engaged in by the companies, whereas others engage in detailed reporting of material substantive risks and impacts that are relevant to the company.[25]

6.33 The inconsistency derives from the fact that in Australia there is no common sustainability reporting framework. This has prompted the Environment Minister, Senator the Hon Ian Campbell, to refer the question of the inclusion of a voluntary standardised framework to the ASX Council Recommendations.

6.34 The significant market implications of inconsistent sustainability information were highlighted in a research report, *Sustainability – Practices, Performance and Potential*, undertaken for CPA Australia. This research, which examined sustainability reporting by Australian companies:

> ...clearly shows that its value and contribution to more informed stakeholders is undermined by the absence of a common reporting framework. Without a common basis to reporting, users are unable to compare information across time and across companies and so penalise or reward companies. This outcome is reflected in the failure of capital markets to value sustainability information and suggests that market forces are unlikely to drive future improvements to sustainability reporting and by association corporate practices.[26]

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23 Mr Gene McGlynn, Assistant Secretary, Department of the Environment and Heritage, *Committee Hansard*, 27 March 2006, p. 29.

24 Mr Matthew Brine, Manager, Governance and Insolvency Unit, Department of the Treasury, *Committee Hansard*, 29 March 2006, p. 18; and Australian Securities and Investments Commission, *Submission to the Corporations and Markets Advisor Committee's Corporate Social Responsibility inquiry*, p. 3, http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFSubmissions_2/$file/ASIC_CSR.pdf (accessed 30 may 2006).

25 Mr Philip Cohn, Assistant Director, RepuTex Australia Pacific, *Committee Hansard*, 23 February 2006, p. 23.

26 CPA Australia, *Submission 103*, p. 4.

6.35 In this regard the Environment Minister has commented that 'Australian companies will need to improve the quality and comparability of reports to ensure they are more business relevant.'[27]

6.36 It was widely recognised that if a common reporting framework were to be adopted in Australia, due to the globalised nature of world financial markets, it would need to be consistent with international approaches. Ms O'Halloran of the Ethical Investment Association made the point this way:

> It would be folly to go down any route other than to have a global reporting standard. I just think it would be a waste of time. ... So much of the investment markets that operate within Australia happen on an international level, so analysts need to be able to compare and contrast between sectors and between companies within sectors on a global basis. They are competing for that investment firm's money with the same risk parameters, the same opportunities and the same uncertainties. They need to be able to compare and contrast on that level.[28]

6.37 It was almost universally acknowledged that the Global Reporting Initiative (GRI) is the emerging international standard for sustainability reporting. According to DEH:

> There are a number of frameworks available for non-financial reporting. Over the past few years however it has become clear that the [GRI] is emerging as the most widely used international framework for reporting.
>
> The 2005 KPMG International Survey of Corporate Responsibility Reporting found the GRI Guidelines are the most common tool used to decide report content and 40% of reporters world-wide mention the use of these guidelines in their sustainability reports.
>
> Currently, over 700 organisations world-wide are identified as users of the GRI Guidelines for reporting, a dramatic increase over the approximately 200 listed in 2003. In Australia, the 2004 State of Sustainability Reporting survey showed that 40 companies were making use of the GRI guidelines.[29]

6.38 The GRI is discussed in detail in a later section of this chapter.

6.39 There were concerns expressed by several submitters regarding the possible introduction of a common sustainability reporting framework, including whether it would be sufficiently flexible to accommodate Australia's diverse market, and the

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27 Senator the Hon Ian Campbell, Foreword to a report by the Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 1.

28 Ms Louise O'Halloran, Executive Director, Ethical Investment Association, *Committee Hansard*, 23 November 2005, p. 33. This view was endorsed by Mr Matthew Brine, Manager, Governance and Insolvency Unit, Department of the Treasury, *Committee Hansard*, 29 March 2006, p. 26.

29 Department of the Environment and Heritage, *Submission 116*, p. 5.

potentially onerous undertaking required to be fully 'in accordance with' the GRI framework.

6.40 In regard to the former issue, Mr Sheehy of CSA questioned the GRI's flexibility, stating that 'I cannot imagine that any one reporting framework would suit absolutely every organisation.'[30] He went on to concede that a sectoral approach (which is available in certain sectors under the GRI) would overcome these difficulties.

6.41 In relation to the latter, the GRI allows companies to self-identify relevant indicators and then only report on those parts and indicators that are applicable to each company. Furthermore the GRI can be incrementally implemented over a number of years, allowing companies to prioritise important elements in the early years of reporting and then to expand the scope over time.

Committee view

Reporting should remain voluntary

6.42 The committee agrees with the GRI's submission which states:

> ...it is increased quality and quantity of reporting that is more relevant [than whether reporting is voluntary or mandatory]. Different approaches will be needed to achieve this goal in different places, depending on the cultural context, legal and economic frameworks, and the level of understanding between stakeholders.[31]

6.43 The committee acknowledges the various benefits that mandating sustainability reporting would bring, such as improved management of non-financial risks, investor protection and accountability. On balance however, the committee does not believe that there are sufficiently compelling reasons to move from a voluntary to a mandatory framework.

6.44 The committee also agrees with the view of the Business Roundtable on Sustainable Development that mandating sustainability reporting is an inappropriate response to the current pressures,[32] and notes the view that there may be increasing pressure on the legislature to intervene if companies fail to act.

6.45 The committee has concerns that mandating sustainability reporting in the current Australian context would promote form over substance. As a result of these

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30 Mr Tim Sheehy, Chief Executive, Chartered Secretaries Australia, *Committee Hansard*, 23 November 2005, p. 49.

31 Global Reporting Initiative, *Submission 130*, p. 4.

32 Business Roundtable on Sustainable Development, *Submission to the Corporations and Markets Advisory Committee's Corporate Social Responsibility inquiry*, p. 2, http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFSubmissions_2/$file/BRSD_CSR.pdf (accessed 30 May 2006).

issues 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.

Recommendation 5

6.46 The committee recommends that sustainability reporting in Australia should remain voluntary.

6.47 Despite this recommendation the committee finds persuasive the view put by ASIC in evidence that increasing the level of reporting may be a better way to encourage corporate responsibility than seeking to mandate it through an amendment to directors' duties.[33]

Cost-effective

6.48 The committee believes that the principle of cost-effectiveness is a central concern that will influence the level and nature of sustainability reporting in Australia. The committee makes a recommendation to improve the cost-effectiveness of companies responding to requests for sustainability information and investors and stakeholders seeking out sustainability information in chapter 8 (Recommendation 16).

Flexible

6.49 The committee supports the principle of flexibility in sustainability reporting, noting that the ASX Council's 'if not, why not' approach provides a balanced mechanism to achieve flexibility.

Comparability

6.50 The committee fully supports Senator Campbell's reference to the ASX Corporate Governance Council. The committee acknowledges the importance of moving towards an internationally recognised framework as the Australian voluntary sustainability reporting standard. In chapter 7 the committee makes a recommendation in relation to the GRI.

Forms of sustainability reports

6.51 Sustainability reporting currently takes various forms and is referred to by many names. As noted above, sustainability reporting refers to the practice of corporations and other organisations measuring and publicly reporting on their economic, social and environmental performance. The sustainability performance information may be presented as part of an organisation's annual report, or in a stand

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33 Mr Jeremy Cooper, Deputy Chairman, Australian Securities and Investments Commission, *Committee Hansard,* 29 March 2006, p. 11.

alone report. Non-financial information is also often presented less formally as part of a company's Internet website.

6.52 The precursors to sustainability reporting were single issue reports that focussed on either environmental or social performance. The titles of these early non-financial reports, for example 'community impact report', 'stakeholder impact report' or 'environmental impact report' reflect their one-dimensional nature.

6.53 Over time, as the concept of sustainability has gained wider acceptance and credence, the presentation of non-financial information is coalescing in integrated sustainability reports. Today there is a worldwide trend toward greater use of sustainability reports instead of other types of non-financial reports, and this is also evident in trends across Australia.[34]

Committee view

6.54 The committee is of the view that the concept of 'sustainability reporting' is preferable to other notions of integrated financial and non-financial reporting. There are obvious similarities between sustainability reporting, triple bottom line reporting and corporate responsibility reporting. They all refer to the practice of organisations reporting on their economic, social and environmental performance. In the committee's view the label 'sustainability report' is preferable for two reasons. Firstly, sustainability reporting is a broader concept than triple bottom line reporting. The concept of sustainability encompasses a long-term perspective which triple bottom line reporting does not. Indeed, sustainability reports will often have forward looking elements as well as outlining past company performance. Sustainability reporting therefore takes into account a broader range of future non-financial risks.

6.55 The other reason for preferring the label 'sustainability reporting' is a practical one. A recent CPA Australia's survey found that respondents were far more familiar with the concept of 'sustainability' than 'triple bottom line'.[35] Of the 300 members of the public that were surveyed, 90 per cent were aware of the term 'sustainability' whereas only 27 per cent were aware of the term 'triple bottom line reporting'. Across the entire range of survey participants, which also included shareholders, investment analysts and company directors the results were 95 per cent recognition of the term 'sustainability' compared to only 48 per cent of the term 'triple bottom line reporting'. Throughout the remainder of this report the term sustainability reporting will be used.

Taxonomy

6.56 Before discussing the issues raised in relation to the appropriateness of sustainability reporting in Australia it is useful to give some detail on the types of

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34 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 38.

35 CPA Australia, *Submission 103b*, p. 6.

reporting framework and other policy instruments that are relevant in this area, as well as the different types of non-financial reports that are produced. Broadly speaking the various forms of reporting frameworks can be divided into three main categories – codes, standards and reporting guidelines. Arguably, codes and standards are equally relevant to how a company performs as to what a company reports. These two categories are included in this section because often it is a code or a standard that is the information being disclosed by a company. The main examples of each of these categories are presented below.

Codes of conduct

6.57 Codes of corporate conduct are voluntary initiatives which set out a series of principles or values which corporations may adopt to guide their criteria for decision-making and its ground rules for appropriate corporate behaviour. An increasing number of organisations are realising the importance and value of explicitly communicating their values and guiding principles in a published code of conduct. An important driver for this shift is the heightened concern resulting from corporate scandals and their impact on the capital markets and investors. Questionable business practices and even individual incidents of improper conduct reflect, to some degree, the values, attitudes and beliefs of the organisation in which they occur.

6.58 Given their broad and voluntary nature, there are obvious practical limits to the effectiveness of codes of conduct. Unless they form part of a company's key performance indicators or reporting requirements, codes can be passive and ineffective documents. Ms Cox noted their practical limits stating:

> Codes of conduct can be useful but are limited where these attempt to specify behaviour which may not be owned or practiced. Sometimes these documents may be unknown to the organisations, others may be seen as either too ambitious or not practical, others may be too specific and therefore failing to give wider guidance.[36]

6.59 However, as the commentary to the ASX Council Recommendations recognises, while it is not possible to regulate the personal integrity of directors and senior executives:

> ...investor confidence can be enhanced if the company clearly articulates the practices by which it intends directors and key executives to abide.
>
> Each company should determine its own policies designed to influence appropriate behaviour by directors and key executives. A code of conduct is an effective way to guide the behaviour of directors and key executives and demonstrate the commitment of the company to ethical practices.[37]

36 Ms Eva Cox, *Submission 26*, p. 3.

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

Principles 3 and 10, ASX Council Recommendations

6.60 In Australia there is an expectation for publicly listed companies and trusts to establish a code of conduct to promote actively ethical and responsible decision making. This expectation arises from the ASX Council Recommendations which are discussed in more detail in the following chapter. Briefly, Principle 3 of the ASX Council Recommendations states:

> The company should:
>
> - clarify the standards of ethical behaviour required of company directors and key executives ... and encourage the observance of those standards
> - publish its position concerning the issue of board and employee trading in company securities and in associated products which operate to limit the economic risk of those securities.[38]

6.61 Principle 10 of the ASX Council Recommendations which relates to the recognition of the legitimate interests of stakeholders is also relevant. It acknowledges that 'it is important for companies to demonstrate their commitment to appropriate corporate practices.'[39]

6.62 In order to satisfy these principles the ASX Corporate Governance Council recommends that corporations establish a code of conduct to:

- guide the directors, the chief executive officer (or equivalent), the chief financial officer (or equivalent) and any other key executives as to:
  - the practices necessary to maintain confidence in the company's integrity;
  - the responsibility and accountability of individuals for reporting and investigating reports of unethical practices (Recommendation 3.1); and
- guide compliance with legal and other obligations to legitimate stakeholders (Recommendation 10.1).[40]

6.63 The ASX Council Recommendations provide useful non-prescriptive guidance and suggestions for the content of a code of conduct.

6.64 As noted earlier, the ASX Council Recommendations only apply to publicly listed companies and trusts. For this reason both the NSW Young Lawyers and Mr Wishart expressed support for a legislative amendment to enable the introduction

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

39 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 59.

40 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, pp 25 and 59.

of a code of conduct to all entities governed by the *Corporations Act 2001*.[41] Mr Wishart suggested that this could be achieved by way of a replaceable rule. The committee notes in this regard that there is already an Australian Standard, AS 8003-2003, which relates to organisational codes of conduct. This standard sets out the essential elements for establishing, implementing and managing an effective organisational code of conduct and applies equally to listed and non-listed entities.

UN Global Compact

6.65 The Global Compact is an initiative of the United Nations that facilitates a network of UN agencies, governments, business, labour, and non-government organisations to encourage companies to adopt ten principles in the areas of human rights, labour, environment, and anti-corruption.

6.66 The Global Compact is a voluntary initiative that seeks to promote responsible corporate citizenship. It seeks to advance ten universal principles drawn from the Universal Declaration of Human Rights, the International Labour Organisation Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development and the UN Convention against Corruption. The principles call for business to support and protect human rights, respect workplace rights, take greater environmental responsibility and work against corruption.

6.67 The Global Compact is not a regulatory instrument. It does not enforce or measure the behaviour or actions of companies. Rather, the Global Compact relies on public accountability, transparency and the enlightened self-interest of companies, labour and civil society to initiate and share substantive action in pursuing the principles upon which the Global Compact is based.[42]

6.68 Companies voluntarily participating in the Global Compact have the opportunity to engage in a range of multi-stakeholder networks to assist them to implement and advocate the principles. Companies are encouraged to develop their examples of corporate change into case studies and are expected to publish in their annual report or sustainability report a description of the ways in which they are supporting the Global Compact and its ten principles. There are a range of publications to assist companies in implementing the principles.

6.69 Some submitters rejected the UN Global Compact as 'a contrivance to entice the corporate world to deliver on [a number of UN conventions].'[43]

41 NSW Young Lawyers Pro Bono and Community Services Taskforce, *Submission 65*, pp 17–19 and Mr David Wishart, *Submission 140*, p. 9.

42 www.unglobalcompact.org/AboutTheGC/index.html (accessed 20 April 2006)

43 The Hon Dr Gary Johns, *Attachment to Submission 126*, p. 2.

6.70 Despite this criticism, a number of leading Australian companies that appeared before or provided submissions to the committee are signatories to the Global Compact, including Shell Australia, BHP Billiton, Westpac, Newmont Australia, Future Eye and RMIT University. The number of Australian organisations that are signatories to the Global Compact is steadily growing, with the total currently standing at 20. There are also a number of foreign-owned companies operating in Australia, the parent company of which is a signatory. World-wide there are around 3000 businesses and organisations that are participants.

OECD Multinational Enterprises Guidelines

6.71 Australia is a signatory to the *OECD Declaration on International Investment and Multinational Enterprises* (OECD Guidelines), non-binding guidelines that provide voluntary principles and standards for responsible business conduct. The OECD Guidelines establish principles of corporate responsibility covering a broad range of issues including human rights, information disclosure, employment and industrial relations, environment, combating bribery and consumer interests. Guidelines have been prepared in consultation with business and trade union representative bodies, as well as non-government organisations. The OECD Guidelines apply to the operations of multinational enterprises, even in non-OECD countries, and require Multinational Enterprises (MNEs) to 'encourage, where practicable, business partners, including suppliers and subcontractors, to apply principles of corporate conduct compatible with the Guidelines.'[44]

6.72 The Treasury which has a role promoting and implementing the OECD Guidelines as the National Contact Point, stated:

> Observance of the OECD guidelines by enterprises is voluntary and not legally enforceable. However, governments adhering to the OECD guidelines are committed both to promoting the guidelines and establishing National Contact Points to act as a forum for discussion of all matters relating to the guidelines, including the review of 'specific instances'. An important aspect of the OECD guidelines is the formal review mechanism that allows parties to raise 'specific instances' in which the behaviour of enterprises may have been inconsistent with the guidelines. The Australian National Contact Point for the OECD guidelines is the Executive Member of the Foreign Investment Review Board.[45]

6.73 According to Dr Sean Cooney of the Centre for Employment and Labour Relations Law, University of Melbourne, there have been no 'specific instance' complaints relating to Australian operations since 2000, while there have been 64 complaints in other parts of the world over the same period.[46]

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44 Organisation for Economic Co-operation and Development, *OECD Declaration on International Investment and Multinational Enterprises*, November 2000, p. 11.

45 Department of the Treasury, *Submission 134*, p. 11.

46 Dr Sean Rooney, *Attachment to Submission 104*, p. 25.

6.74 Dr Cooney expressed support for the OECD Guidelines:

> ...the Guidelines have significant normative force, constituting an agreed statement of principles by the OECD nations. They appear to be playing a significant role as a reference point for policy-making in relation to CSR [for example Standards Australia's Corporate Governance, Corporate Social Responsibility and Bribery papers, Australia's Triple Bottom Line Reporting Guidelines, Australia's Environmental Reporting Guidelines and the Australian Securities and Investment Commission's Socially Responsible Investing Disclosure Guidelines]. Moreover, the Australian [National Contact Point] is actively promoting the Guidelines with Australian business and seeking to diffuse information about the Guidelines and other CSR initiatives through a well-developed website.[47]

6.75 Subsequent to Dr Cooney's submission, the committee has learnt of a recent 'specific instance' complaint that has led to a mediated outcome involving Global Solutions Limited Australia, the company responsible for the management and day to day operations of Australia's immigration detention centres.[48] This example demonstrates the effectiveness of the OECD Guidelines in improving corporate performance.

6.76 A number of other codes of conduct that relate specifically to one aspect of corporate responsibility were brought to the committee's attention. Examples in relation to human rights and labour standards included the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy, and the draft UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights.[49] Dr Zappalà points out that 'according to an OECD survey there were almost 250 voluntary codes of conduct with relevance to corporate citizenship.'[50]

Standards

6.77 The adoption of national and international standards is another voluntary way that corporations can obtain basic guidance about integrating corporate responsibility into their operations. The International Standards Organisation (ISO) has developed an extensive range of standards, some of which are directly related to aspects of corporate responsibility such as the ISO 14000 series on environment management systems. The ISO is developing the ISO 26000 Guideline for Social Responsibility, which is expected to be released in 2008.

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47 Dr Sean Rooney, *Attachment to Submission 104*, p. 25.

48 Statement by the Australian National Contact Point 'GSL Australia Specific Instance', April 2006, http://www.ausncp.gov.au/content/docs/298_343_Final%20Statement.pdf (accessed 30 May 2006).

49 Regarding the former, see for example the Australian Council of Trade Unions, *Submission 10*, and the latter, see for example the PILCH Homeless Persons' Legal Clinic, *Submission 4*.

50 Dr Gianni Zappalà, *Submission 2*, p. 12.

Australian Standard on Corporate Social Responsibility (AS 8003-2003)

6.78 In July 2003 Standards Australia released a specific voluntary standard on corporate responsibility that provides basic guidance about integrating corporate responsibility into operations (AS 8003-2003). It forms part of a five-part suite of corporate governance standards (AS 8000 Business Governance Suite). AS 8003-2003 sets out the essential elements for establishing, implementing and maintaining an effective corporate social responsibility program within an entity, and then goes into more detail by providing guidance as to how these elements should be used. The AS 8000 suite is aimed at all companies, including the smaller non-listed companies, both for profit and non-profit, that are not covered by the ASX Council Recommendations.

Assurance standards

6.79 There are also standards that apply to the independent verification of sustainability reports. Independent verification provides internal and external assurance that the data and content reported, and claims made, are validated by an independent party.

6.80 The most commonly used standard for independent verification is the AA1000 assurance standard. The AA1000 framework is a measurement tool devised by AccountAbility to complement and build upon the GRI Reporting Guidelines. It provides guidance on how to establish a systematic stakeholder engagement process that generates the indicators, targets and reporting systems needed to ensure its effectiveness in impacting on decisions, activities and overall organisational performance.

6.81 Another more recent assurance standard is the ISAE3000 developed by the International Assurance and Auditing Standards Board. It is a generic standard for assurance engagements including non-financial performance and conditions and behaviour, such as corporate governance and human resource practices.

Reporting guidelines

6.82 There are a number of frameworks available for non-financial reporting. There is also a range of reporting guidelines available in Australia that have been specifically tailored for the Australian context, which are discussed below.

Global Reporting Initiative

6.83 During the course of the inquiry, perhaps the most commonly used acronym aside from 'CSR' was 'GRI'. GRI stands for the Global Reporting Initiative, a multi-stakeholder process whose mission is to develop and disseminate globally applicable guidelines for sustainability reporting. According to the GRI submission:

> GRI's purpose is to make sustainability reporting as common and widespread as financial reporting so that it will be routine for companies and other organisations to account for the contributions they make to – and

the impact they have on – the globe's natural resources, societies, and economies.[51]

6.84 The organisation began in 1997 and became an independent institution in 2002. It is an official collaborating centre of the United Nations Environment Programme and works in cooperation with UN Global Compact.

6.85 The GRI *Sustainability Reporting Guidelines* (the GRI Guidelines) are for voluntary use by organisations for reporting on the economic, environmental, and social dimensions of their activities, products, and services. The GRI has a global network of experts from accountancy, business, civil society, investment, labour and others, who contribute on a voluntary basis to the governance of GRI and to the development and dissemination of the GRI Guidelines.

6.86 The GRI Guidelines include a set of 11 reporting principles that are aimed at producing informative, balanced, transparent and comparable sustainability reports. The principles include transparency, relevance, accuracy, neutrality, comparability and timeliness, some of which have similarities and overlaps with those used in financial reporting.

6.87 The GRI Guidelines also clearly set out expectations for the content of sustainability reports. Importantly, this section of the Guidelines includes a series of economic, social and environmental indicators that are broadly applicable to all organisations. The indicators are structured so that they elicit comparable information on the performance of many organisations. Not all indicators will be relevant to all organisations and the GRI encourages reporting organisations to consult with stakeholders and develop an appropriate shortlist of performance indicators to include in their reports.

6.88 There are several other complementary elements of the GRI Guidelines which go to make up the GRI Framework. These include:

- an expanding collection of Sector Supplements which provide specific guidance to assist with interpreting the Guidelines, and offer new indicators to ensure that reporting meets the focused needs of industry sectors and their stakeholders. Sector Supplements currently cover financial services, mining and metals, telecommunications, automotive, tour operators and public agencies; and
- a series of Technical Protocols, each designed to addresses a specific indicator or set of indicators by providing detailed definitions, procedures, formulae and references to ensure consistency across reports. Over time, most of the indicators in the GRI Guidelines will be supported by a specific technical protocol.

51 Global Reporting Initiative, *Submission 130*, p. 1.

6.89 Importantly, the GRI Framework has a range of flexibility mechanisms to enhance its applicability and accessibility to the enormously diverse range of organisations (large and small, public and private, for-profit and non-profit) that may wish to adopt the GRI reporting structure. The GRI Guidelines state:

> GRI encourages the use of the GRI *Guidelines* by all organisations, regardless of their experience in preparing sustainability reports. The *Guidelines* are structured so that all organisations, from beginners to sophisticated reporters, can readily find a comfortable place along a continuum of options.
>
> Recognising these varying levels of experience, GRI provides ample flexibility in how organisations use the *Guidelines*. The options range from adherence to a set of conditions for preparing a report 'in accordance' with the *Guidelines* to an informal approach. The latter begins with partial adherence to the reporting principles and/or report content in the *Guidelines* and incrementally moves to fuller adoption.[52]

6.90 In its submission, Insurance Australia Group (IAG) highlighted the importance of the flexibility of GRI Guidelines to corporations:

> One of the central features of the GRI Guidelines is the fact that participation is voluntary and organisations are permitted to report against any or all of the indicators. The flexibility in the number of indicators to be reported allows an organisation to build capability over time. In a practical sense, companies that have not previously measured social and environmental performance need time and resources to build and manage the systems that will enable them to measure, benchmark and improve performance across non-financial dimensions.[53]

6.91 As a result, the GRI Framework enables reporters to select an approach that is suitable to their individual organisations. GRI based reports are able to be customised in a number of ways. For example organisations are able to select performance indicators which are most relevant to their circumstances.[54]

6.92 There are also specially tailored guidelines available to support small to medium enterprises (SMEs) wishing to undertake sustainability reporting. The *High 5!* handbook is a 'beginner's guide' that offers guidance and practical advice to SMEs on using the GRI Guidelines.

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52 Global Reporting Initiative, *Sustainability Reporting Guidelines*, 2002, p. 13.

53 Insurance Australia Group, *Submission 29*, p. 20.

54 The GRI Guidelines classify performance indicators as either 'core' or 'additional,' with core indicators being those relevant to most reporting organisations and of interest to most stakeholders. Reporting organisations that choose to report 'in accordance' with the GRI Framework must note the reasons for the omissions of any core indicators. The factors that may explain the omission of a core indicator include protection of proprietary information; lack of data systems to generate the required information; and that a specific indicator is not relevant to an organisation's operations.

6.93 Throughout the inquiry the GRI Framework was repeatedly referred to as the internationally recognised standard for sustainability reporting. For example, Ms O'Halloran of the Ethical Investment Association stated:

> It has been so entrenched. At every single meeting I go to in any other country the Global Reporting Initiative is fully supported by organisations, by governments and by the financial markets. It seems to be a standard that is absolutely embraced worldwide.[55]

6.94 The GRI Framework is now used by over 800 organisations in 51 countries. As a result the GRI is used in the preparation of 40 per cent of sustainability reports worldwide.[56]

6.95 The proportion of Australian companies that are adopting the GRI is increasing rapidly. Between 2004 and 2005 the preparation of sustainability reports in Australia using the GRI Guidelines has grown from 30 to 51 per cent.[57]

6.96 The GRI is currently progressing through the third major revision of its Guidelines, at the conclusion of which the revised Guidelines, known as the G3, will be launched in October 2006. The G3 revision is intend to improve the robustness of the GRI Framework; cater more for investors and the capital market; provide digital solutions for the delivery of the G3 Guidelines; and development of educational support materials and programs. These refinements to the GRI have the potential to make them more accessible and applicable to a greater number of organisations.[58]

Australian reporting guidelines[59]

6.97 In 2003, the Department of the Environment and Heritage (DEH) developed a guide for public environmental reporting in the Australian context.[60] This guide, titled *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators* complements the GRI Guidelines by 'providing Australian organisations with tangible and easy to use methodologies for measuring performance

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55 Ms Louise O'Halloran, Executive Director, Ethical Investment Association, *Committee Hansard*, 23 November 2005, p. 34.

56 KPMG Global Sustainability Services, *KPMG International Survey of Corporate Responsibility Reporting 2005*, June 2005, p. 20.

57 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 4. The report shows that about 60 per cent of the companies using the GRI Guidelines are internationally owned.

58 Dr Judy Henderson, Chairperson, Global Reporting Initiative, *Committee Hansard*, 10 March 2006, p. 28.

59 This section is based in part on a submission by Mr Richard Turner, *Submission 5*, pp 19–20.

60 Department of the Environment and Heritage, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators*, June 2003.

against key environmental indicators'.[61] The DEH guide provides an eight-step process that organisations can follow in preparing a public environmental report. While the DEH guide is focused on environmental reporting, the steps set out in the DEH guide appear equally applicable to other aspects of sustainability reporting.

6.98 The DEH guide cites strong support for the GRI Framework during stakeholder consultation.[62] Some minor deviations from the GRI were adopted to address Australian conditions, reduce complexity, or in response to shareholder feedback. In providing a reporting framework the DEH guide makes the distinction between 'environmental management indicators' which 'provide information on how a company manages any environmental impacts of its operations, products and services', and 'environmental performance indicators' which 'calculate and report on the impact its operations have on the environment.'[63]

6.99 The DEH guide can be used by directors to discharge their duty if they are obliged under paragraph 299(1)(f) of the *Corporations Act 2001* to report on the company's environmental impact.

6.100 In 2004, the then Department of Family and Community Services released a draft guide to assist companies to report on their social impacts.[64] The draft guide is also based on the GRI Guidelines. As social indicators are less quantitative than environmental indicators, they tend to require more information about internal processes and policies than actual performance. As a result, the major challenge with social indicators is to ensure consistency with definitions in order to allow comparability. There was no indication in the submission from the Department of Family, Community Services and Indigenous Affairs whether, and if so when, it intends to finalise the draft guide.

6.101 There are several notable private sector initiatives in relation to developing guidelines for sustainability reporting.

6.102 In 2003, in order to facilitate the understanding of members, the Group of 100 (G100), representing the Chief Financial Officers of large business enterprises in Australia, produced a guide to sustainability reporting, *Sustainability: A Guide to Triple Bottom Line Reporting*. This guide is not a sustainability reporting guide as such. It is intended to provide an explanatory guide for senior executives considering

61 Department of the Environment and Heritage, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators*, June 2003, p. iii.

62 Department of the Environment and Heritage, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators*, June 2003, p. 10.

63 Department of the Environment and Heritage, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators*, June 2003, pp 14 and 20, respectively.

64 Department of Family and Community Services, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Social Indicators*, Draft in Discussion, July 2004.

sustainability reporting, outlining concepts and key issues associated with sustainability reporting.

6.103 With the assistance of a $1 million grant from the Australian Government, CPA Australia and the University of Sydney are currently collaborating to develop a framework for managing and reporting non-financial information.[65] The Australian Accounting Standards Board has also announced it is looking at developing a standard for triple bottom line accounting.[66]

Sustainability indices

6.104 The growing importance of corporate responsibility to financial markets and the emergence of a new breed of investors known as ethical investors, has led to the establishment of sustainability indices. Sustainability indices seek to rank corporations with respect to their overall financial and non-financial performance and also allow investors to track the performance of sustainable investments. Overseas examples, which have developed more extensively than those in Australia, include the US's Dow Jones Sustainability Index, the UK's FTSE4Good, the Canadian Jantzi Social Index, and the South African Johannesburg Securities Exchange SRI Index.

6.105 By comparison, the emergence of sustainability indices in Australia has been slow, largely due to the low participation rates of Australian corporations in voluntary indices and the difficulties in accessing reliable non-financial information. The three main Australian sustainability indices are described below.

Corporate Responsibility Index

6.106 The committee notes the recently established Corporate Responsibility Index (CRI), in which participating *BRW* top 250 companies voluntarily agree to be ranked publicly on their non-financial performance. In 2005, 29 such companies agreed to participate, submitting themselves to a detailed self-assessment process subject to validation by Ernst & Young. Compiled annually, the third CRI was published in May 2006, listing the best performers of 2005. The top five participating companies were Westpac, Toyota Australia, ANZ, BHP Billiton and BOC group.[67]

6.107 According to Dr Longstaff of the St James Ethics Centre, which acts as the 'trustee' for the CRI in Australia and New Zealand:

> The most important features of the CRI are that it offers detailed information that helps corporations to improve their actual performance. Secondly, the reporting process leads to the publication of an Index

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65 Australian Bankers Association, *Submission 106*, p. 3: also CPA Australia, *Submission 103*, p. 34.

66 Australian Bankers Association, *Submission 106*, p. 3.

67 Corporate Responsibility Index webpage, http://www.corporate-responsibility.com.au/results/2005_results.asp (accessed 1 June 2006).

> available for examination by the broader community. ... we believe the CRI provides a powerful tool for encouraging an underlying culture of corporate responsibility.[68]

6.108 The CRI was launched in February 2004, and corporate Australia's participation in the CRI to date has been limited. In its inaugural year, around 10 per cent of Australia's top 250 companies which were invited to participate, did so. Despite the St James Ethics Centre's best endeavours to recruit more participants, the level of participation has only increased marginally in the subsequent two rounds. While giving evidence, Dr Longstaff expressed a degree of frustration at the slow level of take-up in Australia saying '[w]hen you think about it—it was a tool that was initially developed by business for business and it is free—you would ask why.'[69] By comparison, the United Kingdom's version of the CRI has nearly 150 participants, despite its launch occurring less than one year earlier.

6.109 Dr Longstaff suggested that the Government should support mechanisms such as the CRI:

> ...government has an important role to play in encouraging and supporting businesses that voluntarily undertake valid and credible steps to measure, report on and improve their performance in the overlapping areas of corporate governance and responsibility.[70]

6.110 To encourage greater uptake, Dr Longstaff suggested that 'businesses undertaking these commitments should be eligible for 'regulatory relief' – moving from highly prescriptive regimes to a 'principles based' system of co-regulation.'[71] This concept is discussed further in chapter 8 which addresses ways to encourage corporate responsibility.

6.111 The St James Ethics Centre in partnership with the Caux Round Table (CRT) submitted a proposal to introduce the CRT's corporate responsibility risk assessment and behavioural inventory assessment tool, *Arcturus*, to complement the CRI in the Australian market.[72] This tool is intended to engage companies in the voluntary adoption of good governance and corporate responsibility practices, and will assist first time participants to engage voluntarily in corporate responsibility activities such as the CRI. The committee supports further exploration of the *Arcturus* tool.

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68 St James Ethics Centre, *Submission 50*, p. 5.

69 Dr Simon Longstaff, Executive Director, St James Ethics Centre, *Committee Hansard*, 23 November 2005, p. 24.

70 St James Ethics Centre, *Submission 50*, p. 5.

71 St James Ethics Centre, *Submission 50*, p. 5.

72 Joint submission by St James Ethics Centre and Caux Round Table, *Submission 145*, p. 1.

Australian SAM Sustainability Index

6.112 In February 2005, Sustainable Asset Management Australia (SAM) launched the Australian SAM Sustainability Index (AuSSI). To compile the AuSSI a 'corporate sustainability assessment' is conducted to measure and verify the corporate sustainability performance of the Australian companies. The corporate sustainability assessment process invites the largest listed companies in Australia to participate in the assessment. Around 40 to 50 Australian companies participate each year with the remaining companies (approximately 140) being assessed on their publicly available information.

6.113 According to SAM, the AuSSI, which is described as 'corporate Olympics of sustainability',[73] is constructed the in the following manner:

> Each company is allocated a questionnaire accessible in the online database known as the Sustainability Information Management System (SIMS). The questionnaire is composed of approximately 70 to 90 questions which assess the sustainability performance of these Australian companies across three dimensions – economic, environmental and social. The questionnaires focus on leading edge questions that allows the SIMS scoring system to separate leading from laggard companies. Each company is allocated an overall score based on its answers and any additional documentation it provides. The companies are then ranked, in their 21 SAM AuSSI industry sectors, by score order from highest to lowest. ...
>
> The leading 10% of companies in each industry are then chosen as the sustainability leaders for their industry sector. The leaders from each sector are aggregated to form the AuSSI... The AuSSI is reformulated each year with the changes announced in October.[74]

RepuTex SRI Index

6.114 In general terms the RepuTex SRI Index operates in a similar manner and performs a similar function to the AuSSI. Launched in August 2005, the RepuTex SRI Index measures the share market performance of a portfolio of the S&P/ASX300 Index companies listed on the Australian Stock Exchange that demonstrate a required minimum level of socially responsible performance and management of social risk. The RepuTex assessment methodology covers four category areas: Corporate Governance, Environmental Impact, Social Impact and Workplace Practices.

6.115 At its launch, the RepuTex SRI Index comprised 44 companies with a market capitalisation of $427 138 million as at 5 August 2005, representing 52 per cent of the market capitalisation of the S&P/ASX300 Index.

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73 Mr Francis Grey, Research Manager, Sustainable Asset Management Australia, *Committee Hansard*, p. 18.

74 Sustainable Asset Management Australia, *Submission 137*, p. 16.

6.116 The constituent companies are spread across nine Economic Sectors and 14 Industry Groups according to the Global Industry Classification System used for the S&P/ASX300 Index. The major Economic Sector concentration occurs in the Materials, Financials, Industrials and Consumer Staples sectors.

6.117 From the perspective of corporate social responsibility performance, 31 of the 44 companies at launch held a RepuTex rating of 'A', the lowest level of the minimum requirement, whilst seven companies were rated at 'A+', 3 at 'AA-', 2 at 'AA' and 1 at 'AAA'.

State of sustainability reporting in Australia

6.118 In 2005 sustainability reporting was voluntarily undertaken by around 24 per cent of the 500 largest public and private companies operating in Australia.[75] A number of important trends underlie these findings which are detailed in the *State of Sustainability Reporting in Australia 2005* report by the Centre for Australian Ethical Research (the CAER report).

Rate of reporting

6.119 As mentioned in an earlier chapter of this report, corporate Australia lags behind many other developed countries in its rate of sustainability reporting. The CAER report detailed findings from the KPMG's global survey of sustainability reporting practices of June 2005, which found that reporting rates in Australia are lower than in most of the countries surveyed, by percentage of the top 100 publicly listed companies in each country.[76] The average rate across the 16 countries was 41 per cent, compared with 23 per cent in Australia (for the S&P/ASX 100). Countries such as Japan and the United Kingdom have very high rates of sustainability reporting, with 81 and 71 per cent respectively. Australia ranks 14th of the 16 countries surveyed.

6.120 Perhaps not surprisingly given this international comparison, the rate of sustainability reporting by foreign owned companies operating in Australia is more than twice that of Australian owned companies. The average production rate for foreign companies operating in Australia is around 43 per cent, whereas the comparable figure for Australian companies is around 18 per cent.[77]

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75 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 3. The survey was carried out on 500 companies comprised of the S&P/ASX 300 companies, the top 100 unlisted public companies and the top 100 private companies. The results include both stand-alone reports and sustainability sections in annual reports and on reports published in 2004 and 2005.

76 KPMG International, *KPMG International Survey of Corporate Responsibility Reporting 2005*, June 2005.

77 Figures derived from Table 7, Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 28.

6.121 Despite being low by international standards, the rate of sustainability reporting in Australia is increasing rapidly. Data from the CAER report shows strong growth in sustainability reporting by the top 500 companies operating in Australia over the past decade. The recent trends are dominated by an increase in reporting by publicly listed companies. The CAER report speculates that 'the increase over the past year among the S&P/ASX 300 companies may indicate that Australian listed companies are being influenced by the activities overseas and by foreign-owned companies in Australia.'[78] If the current growth rates continue, it could be expected that all of the top 500 companies would be preparing sustainability reports by around 2035.

6.122 The CAER report also identifies a growing trend of companies including a sustainability section in their annual report or on the company's website, although the majority of reports are still issued as stand-alone documents.[79] The use of annual reports to disclose sustainability information is the favoured approach of submitters such as CPA Australia and Professor Deegan.[80]

6.123 Sustainability reporting in Australia is dominated by a number of key sectors including: manufacturing, mining, wholesale trade, finance and utilities. In a number of sectors, no companies have prepared a sustainability report including: hospitalities, health and community services.[81] The CAER report makes special note of the mining and manufacturing sectors, which together account for 55 per cent of sustainability reports, and also the two relevant peak bodies the Plastics and Chemical Industry Association and the Minerals Council of Australia, which both encourage reporting and engagement with sustainability more generally. Chapter 8 highlights some of the important sectoral initiatives that are occurring in Australia.

6.124 According to the CAER report, there has been a dramatic increase in the use of GRI Framework:

> ...[sustainability] reports produced 'in accordance with' the GRI Guidelines increased from five to six, and reports produced 'with reference to' the GRI Guidelines increased from 35 to 61, representing an increase from 30 per cent to 51 per cent of reports using the GRI Guidelines.[82]

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78 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, pp 24–25.

79 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, pp 15 and 21.

80 CPA Australia, *Submission 103A*, p. 2; and Professor Craig Deegan, *Submission 96*, p. 7.

81 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 23.

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

6.125 However, as the majority of companies using the GRI Guidelines in Australia are foreign owned, only about 20 per cent of the sustainability reports produced by Australian owned companies are using the GRI, compared with 40 per cent internationally.[83]

Assurance and verification

6.126 Assurance and verification is another area of growing importance in the area of sustainability reporting. The CAER report states:

> [Forty] of the 119 companies producing a sustainability report/section in Australia in 2004 have their report independently verified, representing 34 per cent of reports, an increase from the 28 per cent independently verified last year.[84]

6.127 The auditing of sustainability reports was generally seen by submitters as a positive development in sustainability reporting, improving their accuracy and credibility. However, two main issues were raised. Firstly, the lack of a standardised framework was seen as problematic to the effectiveness of carrying out audits on sustainability reports.[85] Secondly, the financial cost was cited as an impediment to undertaking an audit by 70 per cent of respondents to the CAER report survey.[86]

6.128 However, independent verification was seen as the most effective way for companies to address claims of 'green washed' sustainability reports – that is, reports that painted a company's performance in only a positive light, and in some cases, being silent in relation to negative performance. Results from CPA Australia's *Confidence in Corporate Reporting 2005* survey demonstrate that a perception of green wash is real, with a majority of respondents (54 per cent) agreeing that sustainability reporting is simply a public relations exercise.[87] The same survey found that a large majority (83 per cent) agreed that "companies' social and environmental reporting is only worthwhile if it is subject to independent audit."[88] IAG was one of a number of companies which gave evidence that sustainability reports 'are only

83 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 41.

84 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 3.

85 Mr Mark Coughlin, National President, CPA Australia, *Committee Hansard*, 23 February 2006, p. 85.

86 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 34.

87 CPA Australia, *Supplementary Submission 103a*, p. 23.

88 CPA Australia, *Supplementary Submission 103a*, p. 23.

worthwhile if you can get that assurance and that assurance comes with a degree of independence.'[89]

Small-to-medium enterprises

6.129 The CAER study found that the uptake rate for smaller corporations is significantly lower. Of the 200 smallest companies in the S&P/ASX 300 around 8 per cent were found to have prepared a sustainability report.[90] This is well below the average for the S&P/ASX 300 of around 18 per cent.[91]

6.130 Many submissions recognised that the impediments, both financial and resource or personnel, faced by small-to-medium enterprises to undertake sustainability reporting are greater than those faced by large corporations. Mr Cooper of ASIC reminded the committee that:

> There are roughly 1.45 million companies in Australia. ASIC's position is that these issues are relevant only to a very small proportion of those companies. It can be very difficult to speak with any coherence about these issues when you are talking about a proprietary company that might own a newsagency and those sorts of businesses, which make up a very large proportion of the corporate landscape.[92]

6.131 The committee also received evidence that if a general corporate responsibility requirement were to be introduced, then it should apply to either all reporting entities or all corporations, not only to large corporations.[93]

Not-for-profit organisations

6.132 The committee received a small amount of evidence regarding the reporting activities of the not-for profit sector. Habitat for Humanity told the committee that their approach was to report in accordance with the ASX Council Recommendations, to demonstrate that they conform to the same governance framework as their major partners, which are typically public corporations.[94]

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89 Ms Sam Mostyn, Group Executive, Culture and Reputation, Insurance Australia Group, *Committee Hansard*, 9 March 2006, p. 8.

90 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 38.

91 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 28.

92 Mr Jeremy Cooper, Deputy Chairman, Australian Securities and Investments Commission, *Committee Hansard,* 29 March 2006, p. 10.

93 For example Mr Daren Armstrong, Secretary, Legislative Review Task Force, Commercial Law Association of Australia Limited, *Committee Hansard*, 23 November 2005, p. 13.

94 Mr Anthony McLellan, Chairman, Habitat for Humanity Australia, *Committee Hansard*, 9 March 2006, p. 27.

6.133 Amnesty International indicated that while they do not undertake triple bottom line reporting, one of their objectives is to 'ensure that we meet standards of reporting that match the reporting requirements we ask of others'.[95]

6.134 Further evidence in relation to the engagement of the not-for-profit sector with the corporate responsibility agenda in the context of their own operations is discussed in chapter 8.

Engaging institutional investors

6.135 In addition to the various aspects of sustainability reporting outlined in the CAER report, one important theme emerged during the course of the inquiry, that is, the lack of engagement of mainstream financial markets.

6.136 An officer of the Department of the Environment and Heritage described the problem as a 'chicken and egg phenomenon' stating:

> ...financial analysts do not often use sustainability information because the data is not in a form that they can use and then companies do not produce sustainability information because the financial analysts are not demanding it.[96]

6.137 Mr Grey from Sustainable Asset Management Research gave a colourful account of the lack of interest and engagement of mainstream financial markets:

> The financial markets are not just not tuned in; they are not turned on—and they are not even plugged in. The radio is not even in the house. It is somewhere else, down at the shop. They have not gone down and bought it yet. They do not know where the shop is and they do not know it exists. If they went past it, they would think it was a baby-wear shop. So they are seriously not involved.[97]

6.138 Mr Grey went on to say that conversely, many company sustainability reports and other sources of non-financial information have failed to convey effectively to investors the ways in which corporate responsibility activities create value for companies.[98]

6.139 A recent study conducted on behalf of the Australian Council of Super Investors also found that despite the dramatic improvement in the rate of sustainability

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95 Amnesty International, *Submission 90a*, response to question on notice, p. 1.

96 Mr Gene McGlynn, Assistant Secretary, Department of the Environment and Heritage, *Committee Hansard*, 27 March 2006, p. 29.

97 Mr Francis Grey, Research Manager and Founding Principal (Australia), Sustainable Asset Management Research, *Committee Hansard*, 5 April 2006, p. 23.

98 Mr Francis Grey, Research Manager and Founding Principal (Australia), Sustainable Asset Management Research, *Committee Hansard*, 5 April 2006, p. 24.

reporting in Australia 'the capacity of superannuation trustees to undertake enhanced analytics is constrained by the lack of information on material CSR risks.'[99]

6.140 Other submitters also commented on the paucity of non-financial information. For example BT Governance Advisory Service (BTGAS) stated:

> The current reporting requirements for publicly listed companies do not give investors sufficient information to understand the extent to which companies are managing social and environmental risks.[100]

6.141 Information provided by BTGAS illustrated how many companies were not disclosing non-financial information (depending on the nature of the business). A high proportion of the top 200 Australian companies:

- did not publicly disclose information on their processes to protect against violations of consumer privacy;
- made no mention of staff or contractor training with regard to product safety or the handling of materials hazardous to public health;
- did not publicly disclose policies protecting whistleblowers; and
- did not publicly disclose their policy and strategy for workplace safety management.[101]

6.142 Treasury officials also agreed with the proposition that if an investor in a company wanted to maximise their return over the long term they would want to know about the company's material sustainability risks. The Treasury representative went on further to say: 'I think you would be worried about investing in a corporation that did not have these risk management plans.'[102]

6.143 What Mr Mather of BTGAS refers to as the 'lack transparency in the interface between companies and markets' can also be described as a form of market failure.[103] Due to a lack of information relating to material non-financial risks (either because companies are choosing not to provide it or investors are not demanding it), the market is not able to attribute a proper corresponding financial value to these risks. As a result, the non-financial risk management activities that companies are undertaking are currently being undervalued by the market; a distinct disincentive to companies considering undertaking corporate responsibility activities. It also means that organisations that have proactively adopted corporate responsibility are not receiving the appropriate level of financial reward for their actions.

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99 The Hon Dr Ken Coghill, Dr Leeora Black, Mr Dough Holmes, *Submission 71*, p. 62.

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

101 BT Governance Advisory Service, *Submission 19*, pp 2–3.

102 Mr Matthew Brine, Manager, Governance and Insolvency Unit, Department of the Treasury, *Committee Hansard*, 29 March 2006, p. 18.

103 Mr Erik Mather, Head, BT Governance Advisory Service, *Committee Hansard*, 10 March 2006, p. 67.

Greenhouse and energy reporting

6.144 The committee notes the current consideration being given to a national greenhouse and energy reporting framework through the Joint Environment Protection and Heritage Council / Ministerial Council on Energy Policy Working Group. This initiative of the Council of Australian Governments arises from the regulatory duplication resulting from the large number of government programs which require (or invite) businesses to report their energy use and greenhouse gas emissions to Commonwealth, state or territory agencies.

6.145 Because these programs have nearly all evolved independently they differ greatly with regard to their fundamental approaches, the conditions and thresholds for participation, and types of emissions taken into account.

6.146 Many reporting entities participate in more than one program, with the largest emitters being required to submit as many as seven reports. Multiple reporting increases costs and reduces the value of the reporting effort.[104]

6.147 Joint working groups of Commonwealth and state/territory government officials have developed a proposed national framework for greenhouse and energy reporting that would rationalise data requests from government agencies, cut red tape and reduce business costs. The framework comprises a streamlined data set to reduce duplication of reporting requirements and a national online reporting tool to provide a single submission point for greenhouse and energy data.

6.148 As part of the process, officials are examining both non-mandatory and mandatory options, including the merits, costs and benefits of these different approaches for business, consumers and government.

6.149 Both Ministerial Councils will consider the working groups' recommendations by the end of June 2006. COAG will then consider the Ministerial Councils' finding at its meeting of July 2006.

Committee view

Rate of reporting

6.150 The committee is pleased that the rate of Australian companies reporting is increasing rapidly. The committee notes that this trend is occurring without a mandatory reporting requirement. With some additional support and encouragement from both government and business, the committee believes that this trend will continue into the future. The committee makes several recommendations in this regard in chapter 8.

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104 George Wilkenfeld and Associates, *Costs and Benefits of a National Greenhouse and Energy Reporting Framework*, March 2006, p. 2.

International comparison

6.151 The committee would like to see Australia's rate of sustainability reporting reach the average OECD level. In this regard, Mr Turner reminded the committee of its remarks in 2001 in its report in relation to corporate codes of conduct: that high levels of non-financial disclosure would 'enhance the reputation of Australia's corporations, and for that matter, the reputation of Australia itself.'[105] The committee reiterates this view.

6.152 The committee notes in relation to Australia's comparatively low rate of sustainability reporting that it is important to acknowledge that the reporting rate does not necessarily equate to strong or poor corporate performance. As Professor Newman recognised, 'in many ways there are innovations happening on the ground that have not yet been properly written down or incorporated into ways of thinking and decision making.'[106] The committee also notes the result from CPA Australia's survey which shows that twice as many respondents agree than disagree that 'Australian companies are better corporate citizens than overseas companies.'[107] Conversely, the committee also notes empirical evidence such as that referred to in chapter 7 which shows that Australia significantly lags countries in Europe and the US in terms of the proportion of the largest companies that have stated policies which address bribery and corruption amongst their officials.

Global Reporting Initiative

6.153 The committee is strongly supportive of the Global Reporting Initiative multi-stakeholder process. It acknowledges that it is the most widely accepted international sustainability framework and commends those Australian companies which are active contributors to, and participants in the GRI process. The committee endorses Senator Campbell's comments: 'I am also pleased to note the increased focus on sustainability reporting using standardised formats such as the Global Reporting Initiative (GRI) framework.'[108] The committee makes recommendations regarding the GRI in chapters 7 and 8 of this report.

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105 Mr Richard Turner, *Submission 5*, p. 41, quoting the Parliamentary Joint Statutory Committee on Corporations and Securities, *Report on the Corporate Code of Conduct Bill 2000*, June 2001, p. 1.

106 Professor Peter Newman, Director, Institute of Sustainability and Technology Policy, Murdoch University; Chair, Sustainability Roundtable, Western Australian Government, *Committee Hansard*, 20 February 2006, p. 6.

107 CPA Australia, *Supplementary Submission 103a*, p. 23.

108 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 1.

Disclosures in annual reports

6.154 The committee supports the increasing trend of companies including a sustainability section in their annual reports or on the company's website. In the committee's view this is a cost-effective approach to disclosing sustainability information; will prove more accessible to a greater number of stakeholders; and enables greater comprehensiveness in managing non-financial risks. The trend also suggests that companies are progressively integrating sustainability into their core business activities rather than seeing it as 'side show'.

Assurance and verification

6.155 The committee notes the benefits of applying an assurance and verification process to sustainability reports, especially as such an approach militates against accusations of 'green washing', where reports provide only positive information about a company's activities, and are silent about less-than positive aspects of operations. The committee also recognises, however, that there are significant cost implications of verifying sustainability reports. For reasons similar to those outlined for the continuation of voluntary sustainability reporting, the committee supports the continuation of voluntary assurance and verification of sustainability reports. The committee also supports the development, by appropriate industry bodies, of standard verification techniques relevant to each major sector.

Small-to-medium enterprises

6.156 The committee largely agrees with ASIC's view that sustainability reporting is only relevant to a proportion of Australia's larger businesses. In general larger for-profit and not-for-profit organisations will have greater environmental and social impacts, and a greater capacity to finance these initiatives than smaller organisations.

Lack of material non-financial information

6.157 The committee expresses its concern over the paucity of material non-financial information currently being provided to investors. For financial markets to function effectively and to value properly material non-financial risks, this information must be provided to the market. In chapter 7 of this report the committee recommends a flexible and cost-effective approach to encouraging further disclosure of material non-financial information.

Greenhouse and energy reporting

6.158 A consistent national approach to greenhouse and energy reporting could address the current multiple greenhouse and energy reporting requirements, thereby reducing the cost to business of reporting and increasing its value. A national framework would also provide a basis for more transparent and comparable public disclosure of greenhouse emissions and energy use.

6.159 The committee is of the view that establishment of sectoral benchmarks for greenhouse and energy performance would assist companies to identify areas in which they could improve their non-financial performance. The establishment of these benchmarks should be undertaken by government and industry in collaboration. The committee supports liaison between government and industry to develop a mechanism for setting benchmarks.

Recommendation 6

6.160 The committee recommends that the Australian Government, through the Joint Environment Protection and Heritage Council / Ministerial Council on Energy Policy Working Group process, seek to rationalise Australia's greenhouse and energy reporting requirements into a national framework.

Recommendation 7

6.161 The committee recommends that government and industry should liaise on developing a mechanism for setting sectoral benchmarks for greenhouse and energy performance.

Overseas developments

6.162 Over the last decade, there has been a shift towards greater disclosure by corporations of their non-financial performance. The committee was presented with several interesting examples of overseas developments, several of which were recommended for adoption or rejected in the Australian context.

United States

6.163 In response to corporate collapses such as Enron and WorldCom, the United States legislature introduced new corporate governance disclosure requirements under section 404 of the *Sarbanes-Oxley Act 2002*. Under these new rules, listed companies are required to disclose annually whether they have adopted a code of ethics for the company's CEO, CFO, principal accounting officer or controller, or persons performing similar functions. If it has not, a company will be required to explain why it has not.

6.164 The Sarbanes-Oxley approach has been criticised by both the ASX and ASIC for 'creating a huge compliance burden' and for being extremely costly.[109]

6.165 Listed US companies are also under an obligation to disclosure certain aspects of their environmental performance under Securities and Exchange Commission reporting obligations under Items 101 and 103 of Regulation S-K. Disclosures under both these items are subject to a restrictive materiality test that according to CAMAC:

109 Australian Stock Exchange, *Submission 124*, p. 5; and Mr Jeremy Cooper, Deputy Chairman, Australian Securities and Investments Commission, *Committee Hansard,* 29 March 2006, p. 16.

> ...has in general been interpreted to limit the disclosure obligation to any information that is likely to have an immediate effect on the share price of a corporation. This short-term focus means that the disclosure provisions, outlined below, do not apply to longer term environmental trends or developments affecting corporations.[110]

6.166 Item 303 of Regulation S-K requires disclosures of forward-looking and non-financial information in the form of a management discussion and analysis (MD&A). It is similar to operating and financial review under section 299A of the *Corporations Act 2001* (discussed in chapter 7).

European Union

6.167 Over the past decade various national European Union countries have introduced sustainability-related reporting requirements.

6.168 Mr Turner gave the example of Denmark:

> Denmark mandated public environmental reporting in its 'Green Accounting Law' in 1995, requiring over 3000 Danish companies to publish a 'Green Account' describing their impact on the environment and the way in which they manage this impact. Similar legislation has been enacted in the Netherlands affecting over 300 of the nations largest companies.[111]

6.169 In 2001 the French legislature enacted a disclosure framework for sustainability information as part of the Nouvelles Régulations Économiques (NRE). The NRE requires French listed companies to disclose information with respect to corporate governance, social and community impacts, environmental management and workplace practices, which are set out under nine social and nine environmental indicators. The French requirements go beyond what is required by the EU Accounts Modernisation Directive which is described below.

6.170 The European Union has also been actively pursuing greater disclosure of sustainability information. In June 2003, it adopted *EU Accounts Modernisation Directive* (the Directive) which requires European Community corporations to include certain non-financial information in their annual reports.[112]

6.171 The Directive establishes a 'fair review' requirement for large and medium EU companies to provide the following information in their annual reports. It states:

> The annual report shall include at least a fair review of the development and performance of the company's business and of its position, together with a description of the principal risks and uncertainties that it faces.

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110 Corporations and Markets Advisory Committee, *Corporate Responsibility Discussion Paper*, November 2005, p. 87.

111 Mr Richard Turner, *Submission 5*, p. 37.

112 Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003.

> The review shall be a balanced and comprehensive analysis of the development and performance of the company's business and of its position, consistent with the size and complexity of the business.
>
> To the extent necessary for an understanding of the company's development, performance or position, the analysis shall include both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters.[113]

6.172 The Directive's preamble notes that:

> The information [to be included in the annual report] should not be restricted to the financial aspects of the company's business. It is expected that, where appropriate, this should lead to an analysis of environmental and social aspects necessary for an understanding of the company's development, performance or position.[114]

6.173 The Directive sets minimum mandatory standards, which have been implemented by EU countries such as Germany.

6.174 In the United Kingdom a statutory Operating and Financial Review (OFR) came into force in March 2005, providing a framework for the disclosure of sustainability information. The OFR introduced more rigorous requirements than the Directive in relation to forward-looking information, such as information on strategies and longer term policies. Many submitters recommended that the OFR be adopted as the sustainability reporting framework in Australia. During the course of the inquiry however, the UK Government decided to remove the statutory requirement on listed companies to publish OFRs. In January 2006 the relevant legislation was amended, reverting the OFR to a voluntary mechanism.

6.175 Concurrent with the introduction of the statutory OFR, a 'Business Review', consistent with the Directive was introduced. Despite the repeal of the statutory OFR, the new requirement to include a Business Review in UK Directors' Report remains, thus bringing the UK sustainability reporting requirements in line with the Directive.

6.176 Another recent development that is likely to promote further sustainability reporting in Europe is the announcement in March 2006 of the European Alliance on CSR. The Alliance is a broad partnership between the European Commission and the European business community. According to the communication from the European Commission one of Alliance's three key areas of activities is 'raising awareness and improving knowledge on CSR and reporting on its achievements.'[115] This initiative is discussed further in chapter 8.

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113 Official Journal of the European Union, 17 July 2003, p. L178/18.

114 Official Journal of the European Union, 17 July 2003, p. L178/17.

115 COM(2006)136: European Commission, *Implementing the Partnership for Growth and Jobs: Making Europe a Pole of Excellence on Corporate Social Responsibility*, March 2006, p. 10.

South Africa

6.177 Since September 2003, all companies listed on the Johannesburg Securities Exchange (JSE) must now comply with a *Code of Corporate Practices and Conduct*. The Code requires each entity to issue an annual sustainability report, detailing the nature and extent of its social, transformation, ethical, safety, health and environmental management policies and practices. According to paragraph 5.1.3 of the Code:

> ...disclosure of non financial material [in the report] should be governed by the principles of reliability, relevance, clarity, timeliness and verifiability with reference to the Global Reporting Initiative (GRI) Sustainability Reporting Guidelines.[116]

6.178 In a similar fashion to the ASX Corporate Governance Council's *Principles of Good Corporate Governance and Best Practice Recommendations* (discussed below), the JSE listing rules require annual disclosure of the extent of a listed company's compliance with the Code of Corporate Practices and Conduct and the reasons, where relevant, for non compliance.

Committee view

6.179 In the committee's view there is a range of interesting sustainability reporting developments occurring overseas. Although these initiatives have been designed to suit the particular market requirements and community expectations of each country they may be applicable, to varying degrees, to the composition and circumstances of the Australian market. However given the relatively immature state of evolution of sustainability reporting in Australia, that international models are still being developed, and that some degree of rationalisation may be required amongst the various Australian and overseas reporting frameworks, the committee believes it would be inappropriate and premature to adopt an overseas approach.

116 The King Committee on Corporate Governance, *Code of Corporate Practices and Conduct*, 2002, p. 16.