ESG REPORTING GUIDE FOR AUSTRALIAN COMPANIES

BUILDING THE FOUNDATION FOR MEANINGFUL REPORTING

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Financial Services Council (FSC)

The Financial Services Council represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advisory networks. The Council has over 130 members who are responsible for investing more than $1.8 trillion on behalf of 11 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Stock Exchange and is the fourth largest pool of managed funds in the world. The Financial Services Council promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

The Australian Council of Superannuation Investors (ACSI)

The Australian Council of Superannuation Investors (ACSI) represents the interests of 41 'profit-for-member' superannuation funds, who collectively manage over $300 billion in investor funds. ACSI aims to enhance the sustainable long-term value of the retirement savings entrusted to our members as fiduciary institutional investors. ACSI does this by representing the collective rights and interests of members in influencing companies, investors, governments and opinion leaders. Through focussed research and evidence-based policy, communication and advocacy, opportunities to improve ESG practices are identified, and collaborative efforts are made with other institutional investors, to advance our shared goals both in Australia and internationally.

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WELCOME AND INTRODUCTION

The Australian Council of Superannuation Investors (ASCI) and the Financial Services Council (FSC) are delighted to introduce this inaugural *ESG Reporting Guide for Australian Companies*.

Over recent years, investment managers (represented by the FSC) and asset-owners (represented by ACSI) have grown in sophistication in their recognition of the critical importance of environmental, social and governance (ESG) factors to the long-term performance of the companies in which they invest.

While the drivers of this trend are many and varied, there is no question that ESG issues will invariably impact the ability of companies and their investors to achieve sustainable growth and prosperity into the future.

Thus far, institutional investors and companies have struggled to find common ground in defining the ways ESG factors influence their shared goals to achieve sustainable long-term growth and prosperity. Likewise, there has been relatively little shared understanding of how to report on those factors, and how to reconcile them with financial metrics that have traditionally dominated company reporting and investment analysis processes.

The Guide has been prepared to fill precisely that gap.

From the investors' perspective, there is a need for meaningful, accurate, timely and comparable data to help them identify and manage their exposure to ESG investment risks. The provision of this data will assist investment managers in their decisions about selection and holding of stocks in their portfolios. It will also prompt investment managers, broker analysts and asset owners (principally superannuation funds) to constructively engage with companies on these matters.

From companies perspective, it is reasonable to expect consistency and predictability in the data requirements being sought by the institutional investor community, and for reporting obligations not to impose undue costs, competitive disadvantages or other commercial burdens.

Recognising these goals, the Guide has been prepared jointly by ACSI and the FSC to highlight the minimum information and reasonable data requirements that are needed for our member organisations to successfully price, analyse and manage ESG investment risks.

The Guide has been developed to complement reporting requirements spelt out in other best practice guides such as the ASX Corporate Governance Principles and Recommendations, and the existing best practice guides issued by each of our associations.

We look forward to the Guide facilitating an improvement in the disclosure levels, consistency and quality of engagement over ESG issues between Australian companies and their institutional investors.

Ann Byrne
CEO, ASIC

John Brogden
CEO, FSC

BACKGROUND

In 2009 the Australian Council of Superannuation Investors ("ACSI") and the Financial Services Council ("FSC") commissioned a joint project[1] to review and address an apparent lack of integration of environmental, social and governance ("ESG") matters in mainstream investment management. This research looked at the methods of ESG integration in current investment practices and the barriers to wider integration. The research found that the major barriers to integration of ESG factors into investment decision-making processes were:

- Difficulty in quantifying ESG factors;
- A concern about the quality of information being provided; and
- A lack of clear direction from asset owners on their ESG requirements.

A subsequent forum of investment managers and asset owners was held to discuss these barriers and propose solutions to address them. The forum identified that a major cause of the barriers to ESG integration is a lack of disclosure by many companies of information that can meaningfully contribute to integration of ESG factors in investment decision-making and review processes.

In separate research[2], over the last 4 years ACSI has reviewed the sustainability reporting practices of the S&P/ASX 200 companies, ranking companies' sustainability reporting on a scale from no reporting to best practice reporting.

What is notably apparent in the ACSI research is that, even where there is reporting, there is very little consistency between companies as to what is reported and how it is structured. Therefore, much of the information is difficult, or even impossible to use in an investment context due to its lack of comparability or investment readiness.

In February 2010 ACSI and the FSC announced that they would continue to work together to improve the level of public company disclosure on material and relevant ESG factors to enable asset owners and fund managers to holistically assess company valuations.

1 WHY CREATE A GUIDE?

The Guide aims to address the market gaps described above – first, by providing specific guidance on the information that companies should consider and disclose, and secondly, by facilitating greater consistency and comparability of data across different companies and sectors.

The Guide should be seen as a first step towards meaningful disclosure on ESG risks and is particularly targeted at companies who do not report ESG risks or who have begun the process of assessing ESG risks. The Guide does not aim to replace more extensive guides like the Global Reporting Initiative (GRI) which we believe companies should aspire to achieve.

The Guide has been developed by a representative group of investment managers and asset owners (primarily superannuation funds) that in combination represents a wide cross-section of Australia's institutional investor community. The information indicators noted in Chapter 4, have been selected by the people who will use the data, and therefore have direct relevance to the investment decision-making process. This simplifies the process for companies and analysts as each is aware of the reporting expectations of investors, and time and resources are not wasted reporting on irrelevant and unnecessary factors.

[1] ESG integration by mainstream Australian Equity Managers – Research Paper, prepared by Mercer February 2010
[2] Sustainability Reporting Practices of S&P/ASX 200 Companies, conducted by ACSI in 2008, 2009 and 2010

1.2.1 Investor demand

Increasingly, investors are recognising the importance of ESG factors on the long-term performance of the companies in which they invest. In order to price and manage risk during their analysis of an investment, investors need relevant information and companies need to understand the form that information should take.

The importance of the ESG factors extends beyond current liabilities and includes the "externalising" of costs to society at large. Whether direct and deliberate, or incidentally and unintentional, externalised costs risk being internalised by governments and policy makers and so can represent a material risk to companies. Externalised costs should therefore be minimised wherever possible. Proactive management and effective self regulation can reduce the risk of regulatory intervention and allow markets to find efficient solutions while protecting investor interests.

The Guide has been put together to provide companies with the investor community view of the essential information and data that are required to price and manage environmental, social and governance investment risk. The provision of the information will assist investment managers to differentiate stock and prompt analysts and asset owners to engage with companies on these matters.

1.2.2 Simpler analysis

A major issue undermining effective communication between company directors and investors regarding long term business success is a lack of reliable and comparable information regarding broader corporate performance. In addition to traditional financial reporting, investors need consistent and comparable data from year to year to facilitate decision-making on ESG risk. If all companies report in accordance with the same framework or guide, then analysis and comparison becomes much simpler.

1.2.3 ASX Corporate Governance Principles and Recommendations

Corporate Governance is defined by the ASX Corporate Governance Principles and Recommendations as "the framework of rules, relationships, systems and processes by which authority is exercised and controlled in corporations". Effective corporate governance should encompass the means by which those in control of companies are held to account, as well as encouraging companies to create value in line with the corporate strategy, whilst maintaining effective risk management systems and processes.

The ASX Corporate Governance Principles and Recommendations[3] include:

- Principle 1: Lay solid foundations for management and oversight.
- Principle 2: Structure the board to add value.
- Principle 3: Promote ethical and responsible decision-making.
- Principle 4: Safeguard integrity in financial reporting.
- Principle 5: Make timely and balanced disclosure.
- Principle 6: Respect the rights of shareholders.
- Principle 7: Recognise and manage risk.
- Principle 8: Remunerate fairly and responsibly.

When long-term investors look to invest their capital, they must undertake a risk assessment of each company in order to determine that company's suitability with respect to the investment principles of the particular investor.

Principle 7 of the ASX Corporate Governance Principles requires listed entities to establish a sound system of risk oversight, management and internal control. This system should be designed to:

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

This can both help to create shareholder value and to provide for sound management of risk.

ACSI and FSC believe that Principle 7 captures the identification, assessment, monitoring and management of environmental and social issues facing the company and the community in which it operates.

Both ACSI and FSC recognise that there are a significant number of environmental and social issues that will affect different companies at different times and over various periods of time. As investors, we expect companies to disclose the process for identifying risk and the processes involved to manage that risk. Disclosure should also include relevant metrics to allow investors to assess how effective those processes are in managing risk. This document provides guidance on the approach and types of metrics that can be used to provide information on risk management.

NOT JUST ANOTHER ESG SURVEY

ACSI and the FSC are cognisant of the burden created by numerous, ongoing surveys on ESG risk management and performance. We believe that the investor views presented in the Guide, which have been developed after extensive collaboration and research, will assist companies to streamline their reporting as well as reducing the volume of ad hoc information requests that are made by the investor community.

[3] *Corporate Governance Principles and Recommendations Second Edition August 2007*

Importantly, the information indicators in the Guide are drawn from various existing sources, including the:

- Global Reporting Initiative[4];
- Carbon Disclosure Project[5];
- International Corporate Governance Network[6];
- Global Framework for Climate Risk Disclosure[7]; and
- DVFA[8].

These frameworks provide extensive information on ESG disclosure. Where appropriate companies should be aiming to report against these frameworks.

We recognise that many companies already publicly disclose the data that is within the Guide and that, in some cases, data over and above the minimum are reported. **Those companies are not expected to disclose anything more (or less), but we do ask that they confirm that their data is readily accessible.** The Guide will also be a useful audit and benchmarking tool for companies in this situation.

Critically, unlike other ESG surveys, the Guide is intended specifically to facilitate the integration of ESG factors into investment decision making processes. ACSI and the FSC will continue to monitor how the Guide is used by investment managers and superannuation funds to ensure the Guide delivers on its objectives. It is anticipated that the Guide will be raised with companies during analyst briefings and in meetings with institutional shareholders.

[4]GRI Sustainability Reporting Guidelines 3.1 released March 2011

[5]https://www.cdproject.net/en-US/Respond/Pages/overview.aspx

[6]ICGN Global Corporate Governance Principles Revised (2009)

[7]Global Framework for Climate Risk Disclosure: A statement of investor expectations for comprehensive corporate disclosure, Oct 2006

[8]DVFA is the Society of Investment Professionals of Germany. The DVFA Committee on Non-Financials has defined topical areas for the reporting of ESG issues, as well as Key Performance Indicators (KPIs) for use in financial analysis of corporate performance. These KPIs have been endorsed by the European Federation of Financial Analysts Societies (EFFAS) and thus gained the status of an official EFFAS Standard. KPI for ESG: A Guide for the integration of ESG into Financial Analysis and Corporate Valuations, published September 2010

APPLICATION

1.1 WHO DOES THIS GUIDE APPLY TO?

The Guide was created to provide a reporting guide for all Australian companies, with emphasis on those in the S&P/ASX 200.

We recognise that some companies may find full ESG disclosure to be a challenge at the beginning of their reporting journey. However, companies also need to be aware that the issues raised in the Guide are the base level of information that investment analysts require to make stock selection decisions. We would encourage these companies to progressively embrace the principles of risk reporting as they meet their obligations under Principle 7 of the ASX Corporate Governance Principles and Recommendations as they relate to ESG risk.

If not, why not approach

Should a company choose not to report on any ESG related risk, then in accordance with the ASX Corporate Governance Principles and Recommendations we would expect appropriate disclosure on why such reporting is not required under the 'if not, why not' rule.

1.2 HOW SHOULD IT BE APPLIED?

The following factors should be taken into consideration when applying the Guide:

- The format of reporting is at the discretion of the company;
- Any reporting should be easy to locate within a company's communications;
- Reporting should be simple and easily navigated (for example, through the use of an index directing the reader to specific information);
- Any online reporting should be easily searchable;
- Companies are not expected to produce a standalone sustainability report – reporting on sustainability in the annual report is acceptable. In many cases this is preferable;
- Companies are encouraged to consider what ESG reporting, disclosures and communications may be relevant in terms of analyst briefings, annual general meetings and other interactions with investors;
- Where appropriate companies should use the metrics identified against each indicator in the Guide in order to ensure consistency and comparability within and across companies;
- Companies should use their judgment when applying the guide in order to ensure the reporting remains relevant to their specific situation;
- The Guide does not intend to cover every performance criteria that would be found in other reporting standards, and should be considered a minimum level of ESG reporting. ESG reporting beyond the scope of the Guide is encouraged;
- Reporting on sustainability should be released at or around the time that the annual report is released; and
- We strongly encourage companies to announce the release of their sustainability report to the ASX.

1.3 WHEN DO WE EXPECT TO SEE THIS HAPPEN?

We would hope to see reporting against the indicators in the Guide as soon as possible. Many companies will already report on these indicators in their existing sustainability reporting, and **these companies do not need to report any additional information.** We envisage that companies should realistically be able to adopt this reporting Guide for their 2011/12 annual reporting.

REPORTING PRACTICES

2.1 BOUNDARIES – GEOGRAPHIC, CORPORATE AND TEMPORAL

Companies should clearly define their reporting boundaries in relation to included and excluded business entities (e.g. subsidiaries, associates and JVs) and activities. In general, more complete reporting is beneficial to investors.

Considerations should include:

- The geographical scope of business entities and activities;
- Inclusion of equity share businesses and those where operational control of a business or entity may be materially important; and
- The time frame reported against. This should not be limited to the year of reporting.

Many asset managers and asset owners are committed to long term investing, consistent with the time horizon of their ultimate members. In addition, many ESG issues do not impact a company in the short or medium term.

Investors have at times identified a weakness in the reporting of equity share businesses. This is where a reporting company may own a share of a company but fails to report ESG issues arising from that ownership. This additional transparency in reporting gives investors a clear picture of ESG risks and risk management across the entire business, e.g. a company may be a low carbon emitter, but may be liable to carbon regulation through large carbon emissions in a business for which it is 50% owner.

For companies seeking further discussion on reporting boundaries, the Global Reporting Initiative[9] is a source of further detail.

2.2 DETERMINING WHAT IS IMPORTANT, AND WHY

Useful reporting does not equate to providing ever-increasing volumes of data. Rather than asking companies to report on every facet of their ESG performance, we encourage them to:

- Consider and assess what ESG issues are important to their business;
- Understand and explain why they are important; and
- Provide disclosure and reporting on these issues annually (including targets and year on year performance).

Like financial statements, ESG issues which are important to company performance are considered to be 'material' risks or opportunities and are therefore captured under the ASX Corporate Governance Council's disclosure requirements for Principle 7.

Relevance of the indicators

The Guide has been developed by Financial Services industry professionals taking into account a number of other reporting frameworks and guidelines. A selection of indicators has been provided for their expected relevance and applicability, which is dependent on company activity and sector.

[9] *GRI Sustainability Reporting Guidelines. Ob cit*

2.2.1 Materiality

Importantly, companies should not feel obliged to report on all indicators all of the time. The degree to which each indicator is relevant will vary greatly between companies, and the materiality of each factor should be determined by the board and management of the company itself. **Therefore, companies are only expected to report on indicators which are considered to be materially relevant to their business and strategy.**

In considering what issues are material to their individual circumstances, companies are encouraged to refer to the Global Reporting Initiative's definition of materiality, which states:

"The information in a report should cover topics and indicators that reflect the organisation's significant economic, environmental, and social impacts, or that would substantively influence the assessments and decisions of stakeholders."[10]

We also recommend that companies consider the broader Global Reporting Initiative (GRI)[11] framework and the AccountAbility guide 'Redefining Materiality'[12]. The essence of these guides is that materiality should be measured against more than just short term financial considerations and should also be judged against internal and external factors including:

- The company's own policies, statements, goals and strategy;
- Peer based (industry) norms and standards;
- Stakeholder behaviours and concerns;
- Regulatory requirements and other legal obligations; and
- Societal norms and expectations e.g. local community or NGOs.

Materiality should not be judged at a single 'point in time' but should also consider emerging issues and trends over different timeframes (short, medium and long-term). For example; we would expect to already be seeing disclosure from companies that are likely to be directly or indirectly affected by a price on carbon emissions even though at the time of writing legislation on that topic has yet to be put in place.

Finally, as a rule of thumb, material ESG issues can be described in terms of having significant outcomes or consequences which can change depending on how well the issue is managed. Examples are covered in more detail for specific ESG issues later in this document and may include both financial and non-financial outcomes including:

Financial outcomes

i.e. increases or decreases in:

- Cash flows;
- Cost of capital; or
- Asset values.

Non-financial outcomes

i.e. factors that hinder or enhance the ability of the company to:

- Implement strategy;
- Retain key personnel;
- Remain competitive with peers; or
- Retain its social license to operate.

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[10] *Ibid, page 8*
[11] *http://www.globalreporting.org/ReportingFramework/G3Online/DefiningReportContent/LowerBlock/Materiality.htm*
[12] *http://www.accountability.org/about-us/publications/redefining.html*

REPORTING FRAMEWORK

The sections below outline a framework for reporting as part of a company's regular communication to investors.

3.1 HOW ARE ESG ISSUES IDENTIFIED AND MANAGED WITHIN THE COMPANY?

Investors are interested in understanding how material ESG issues potentially impact strategy setting (targets etc) and management's decision-making within the business. This is driven by a range of factors including emergence of new regulations, the ongoing evolution of risk management practices, and further developments in mandatory and voluntary disclosure frameworks.

The way a company approaches the task of identifying, assessing, managing and reporting on ESG related risks, provides investors valuable information into the quality of management and oversight of these issues within the business.

Understanding a company's governance and accountability mechanisms concerning ESG issues helps investors determine how well understood such risks are within the business at the senior management level. A lack of disclosure on ESG issues could for example indicate a lack of resources or a lack of understanding or awareness of how material ESG issues could affect the business.

Such information provides investors with indicators of how well a company is positioned to manage issues such as tightening regulatory standards, evolving market trends, product development and future growth opportunities, or changes in stakeholder expectations – all of which can impact long term business value.

Useful information for investors in this regard includes:

- Internal processes for identifying and reporting material ESG risks and opportunities;
- How such risks and opportunities are reported to the Board, senior management and various internal committees (e.g. Risk Oversight committees);
- Decision-making frameworks on how material ESG risks are managed;
- Processes for establishing ESG related performance targets or goals and links to overall business strategy – e.g. reductions in greenhouse gas emissions, improved OH&S performance, diversity targets etc;
- Person(s) responsible or accountable for ESG related issues within the business including at the Executive level;
- Internal capabilities on ESG, and where such resources are located within the organisational structure;
- The nature and scope of any internal risk reviews on ESG topics;
- Recognising that 'what is measured gets managed', the nature, integrity and controls over ESG related data reporting systems – e.g. OH&S incident reporting; and
- The nature and scope of reporting and disclosures the company undertakes on ESG matters – e.g. external reporting but also disclosures at AGMs and investor meetings (briefings etc.)

3.2 HOW AND WHEN SHOULD A COMPANY REPORT?

Having established what is material and therefore what should be reported, companies then need to consider how to report, and to what degree of detail.

General principles apply with regards to how information should be reported as follows:

3.2.1 Data quality and, consistency

- Investors value good quality, accurate, relevant data over volumes of marketing material therefore data should be comparable and consistently reported with any changes to the methodologies behind data compilation clearly explained.

3.2.2 Data Comparisons

As part of the stock analysis process investors compare past performance against expected short, medium and long term expectations therefore:

- Comparisons should be made against relevant data, which should include the company's past performance, strategic objectives and targets; peers and industry statistics and standards;
- Future performance objectives in relation to the ESG metrics should be clearly stated, ideally include specific performance targets, and be consistent with the overall strategy;
- Timeframes should align with the type of issue or metric and its likely time horizon;
- Thought should be given to reporting a range of possible data outcomes and associated probabilities where a future single target or metric may not be appropriate;
- Where possible, the financial impacts of ESG issues or of meeting or not meeting targets should be reported;
- Information to support relative comparisons may be sourced from authoritative research and forecasts, national and international policy targets. Where possible comparison data should consider location specific data; and
- Report time series data rather than isolated items for the period reported. As many ESG issues evolve over longer time horizons, as much historical data as possible should be reported. For example, a trend in improved safety may take some years to become evident in reported figures; as such a 5 year plus time frame for reporting would be more appropriate than just the prior 12 months.

3.2.3 Commentary and Explanation

As previously indicated, the way a company approaches the task of identifying, assessing, managing and reporting on ESG related risks, provides investors valuable information into the quality of management and oversight of these issues within the business. As such the commentary and explanation provided is meaningful to investors.

- Reporting should include performance information and reasons for significant variances from expectations, both positive and negative;
- Risks to meeting targets should be articulated where possible;
- Where financial impacts cannot be effectively quantified, inclusion of a description of the material issue and facts is appropriate; and
- In setting targets and objectives, key assumptions and aspects of the reporting methodologies should be reported.

The level of detail to report is impacted by the priority of the ESG issue. For example, a relatively low priority issue for the company may be reported in accordance with regulatory requirements alone, whereas it would be expected that a high priority issue would be reported in greater depth and detail.

Further guidance as to how to report can be found in the reporting framework documents – including:

- Global Reporting Initiative (GRI) G3[13],
- GRI Sector profiles[14],
- GRI Technical Protocol[15],
- Carbon Disclosure Project[16]; or
- Integrated Reporting of South Africa Discussion Paper (Jan 11)[17]

[13] *http://www.globalreporting.org/ReportingFramework/ReportingFrameworkOverview/*

[14] *Ibid*

[15] *Ibid*

[16] *https://www.cdproject.net/en-US/Respond/Pages/overview.aspx*

[17] *Framework for Integrated Reporting and the Integrated Report – Discussion Paper, January 2011, Integrated Reporting Committee (IRC) of South Africa*

3.2.4 Where and How to Report

Preferably communication of ESG Key Performance Indicators (targets and achievements) and metrics should be synchronised with financial reporting periods and to the extent possible, included in the financial statements of the company where they are relevant for an understanding of the company's performance and financial position.

3.3 REPORTING INTEGRITY AND TRANSPARENCY

3.3.1 Disclosure of the basis upon which metrics have been prepared

The absence of a generally accepted accounting standards for measuring and presenting environmental, social and governance metrics creates challenges for investors in interpreting performance.

By way of example, one company may include stress related incidents in calculating and reporting on new cases of occupational illness whereas another company may exclude stress related incidents from its calculation and only focus on musculoskeletal illnesses. In this example, simply comparing the headline metric of "New Cases of Occupational Illnesses per 1000 employees" between the two companies is unlikely to provide a like-for-like comparison of underlying performance.

Where they exist, companies should follow generally accepted standards for measuring and presenting metrics. Examples include:

- Measurement of greenhouse and energy data should occur in accordance with the Measurement Determination under the *National Greenhouse and Energy Reporting Act* 2007 or methods of the Intergovernmental Panel on Climate Change (IPCC); and
- Australian Petroleum Production and Exploration Association Limited (APPEA) Safety Incident Reporting Guidelines[18].

Companies should describe to investors any standards that they have applied in the preparation of key ESG metrics. This should be supplemented with details of key definitions and assumptions used in the calculation of metrics where an external standard does not exist or has not been applied.

To facilitate ease of use by investors, it is preferable that a brief 'basis of preparation' explanation or document is made available either within the company's report itself or on its website.

3.3.2 Assurance

Obtaining independent assurance over ESG disclosures provides investors with a greater degree of comfort over their integrity. However, investors recognise that independent assurance comes at a cost that needs to be managed.

Where companies seek assurance over their ESG disclosures it is recommended that it be conducted in accordance with standards of the Australian Auditing and Assurance Standards Board or its international equivalent. Within the framework established under these standards, companies can then focus the scope of assurance on the most material claims or performance metrics reported rather than disclosures that are less material in nature.

[18] *Australian Petroleum Production and Exploration Association Limited Safety Incident Reporting Guideline 2005 (these guidelines are currently under review for release in 2011/12)*

APPLICATION OF THE GUIDE

The Guide broadly divides each of environmental and social issues into four separate themes, for ease of illustrating the issues that may be important for a company and on which to report.

The descriptions of these themes and the metrics suggested for their assessment are not intended to be exhaustive, or to represent a checklist to be simply "ticked off" by companies. Rather, they represent a foundation for the identification and disclosure of ESG issues, upon which companies can build on to develop a report that suits their own particular circumstances.

Companies reporting against each environmental or social issue may wish to report some or all of the "commonly reported indicators", although they do not represent an exhaustive list of indicators for each issue. Relevance of indicators will vary between sectors and materiality will vary by company.

Governance is just as critical as the environmental and social issues. However, as investors' expectations with respect to Corporate Governance have already been comprehensively documented elsewhere, this Guide refers to and incorporates current best practice guidelines under the Governance heading.

Environment

- Climate change
- Environmental management systems and compliance
- Efficiency (waste, water, energy)
- Other environmental issues (e.g. toxics, biodiversity) etc

Social

- Workplaces H&S
- Human capital management
- Corporate conduct (e.g. bribery and corruption)
- Stakeholder management/license to operate

Corporate Governance

- Corporate Governance

Why is it important to investors?

Climate change regulation, and in particular putting a price on carbon, imposes costs on companies that produce and consume carbon-intensive goods and services. Over time, consumption patterns will change in favour of low-carbon goods and services, leading to significant changes in industry structure.

In the long term, the physical effects of climate change such as changes in weather patterns, storm intensity and sea level may put assets at risk.

A company that fails to understand its carbon emissions, reduce its emissions, cost-effectively manage its carbon liability and understand its physical exposure to climate change will risk:

- Higher costs as the cost of complying with carbon regulation increases;
- Loss of market share as customers move to low-emissions suppliers; and
- Damage to assets as the physical impacts of climate change increase.

Companies that produce low-carbon good and services, reduce their carbon emissions and energy use and manage their carbon liability effectively will see benefits flow directly to profits.

Commonly reported indicators

Investors look for:

- Direct (scope 1) emissions by facility or process, including those occurring in equity stakes.
- Indirect (scope 2) emissions associated with purchased electricity.
- Supply-chain carbon emissions (scope 3).
- Opportunities to pass carbon costs on to customers.
- Opportunities to reduce carbon emissions and energy use.
- Targets for reducing carbon emissions and improving energy efficiency.
- Effective carbon liability management, including ways to reduce emissions or meet carbon liabilities at low cost.
- An assessment of the physical risks from climate change.
- Business opportunities that climate change regulation presents.

Resources

The Carbon Disclosure Project provides an excellent framework for reporting carbon emissions and climate change risk: www.cdproject.net

The US Securities and Exchange Commission has published guidance on climate change disclosure: http://www.sec.gov/rules/interp/2010/33-9106.pdf

The Global Reporting Initiative is a widely-used framework for sustainability reporting: www.globalreporting.org

Leading reporter

AGL Energy 2010 Sustainability Report publishes extensive equity-accounted data on its carbon emissions.

ENVIRONMENT

Environmental management systems and compliance

Why is it important to investors?

Operational incidents which impact on the environment within a company's supply chain, direct operations or products can have far reaching implications on shareholder value including:

- Production disruptions as the incident is investigated and new safeguards are put in place;
- Capital costs associated with remediation;
- Compensation costs to affected communities, business partners and employees; and
- The impact on the company's regulatory and/or social license to operate.

A company that can demonstrate a superior commitment, capacity and track record to its peers in the management of environmental risks, may present a lower risk for investors.

Commonly reported indicators

Incidents with a severe environmental impact will often be associated with a health and safety impact. As such, a number of metrics that provide investors with insight over environmental performance may also provide insights into safety performance (and vice versa).

Investors look for:

- Monetary values of fines and number of non-monetary sanctions for non-compliance with environmental laws and regulations.
- Environmental provisions as reported on the balance sheet.
- Number and severity of transgressions of environmental license conditions.
- Losses of containment (number and severity).
- Proportion of operations that are certified under the ISO 14001 Environmental Management Systems Standard.
- Total count of process safety incidents.
- Process safety total incident rate.
- Process safety incident severity rate.

Resources

ISO 14001 Environmental Management System Standard: www.iso.org

Process Safety Leading and Lagging Metrics published by the Centre for Chemical Process Safety provides an excellent overview of metrics related to process safety: http://www.aiche.org/uploadedFiles/CCPS/Metrics/CCPS_ProcessSafety_Metrics_2011_FINAL.pdf

Leading reporter

Orica's 2010 Sustainability Report provides investors with details relating to:

- Instances of non-compliance with environmental license conditions
- Containment losses experienced
- Number of process safety incidents.

Why is it important to investors?

The rapid growth of the global economy and most recently, the emerging economies, has focused the attention of investors on the issue of waste as well as the finite nature of resources, particularly clean water and energy.

In order to support continued global growth and allow for the prosperity of future generations, as well as reduce rising resource costs, companies should minimise waste produced by their operations and manage their demand for fresh water and energy. Failure to achieve efficiencies in this area can lead to:

- Indiscriminate disposal of waste products which might have re-use application;
- Limited waste disposal sites becoming overwhelmed with risk of contamination into surrounding areas;
- Fines for disposal which does not meet environmental regulations;
- Depletion of fresh water resources;
- Loss of arable land;
- Unreliable supply of water and energy;
- Need for high cost alternative sources of fresh water;
- Rising energy and water prices due to scarcity; and
- Higher costs to industry as a result of the additional infrastructure required.

Companies which minimise the creation of waste in their manufacturing process and find ways to reduce their demand for water and energy will see benefits flow directly to the bottom line of their profits.

Commonly reported indicators

Investors look for

- Type of waste produced by product and volume.
- Targets for the reduction of waste.
- % of waste re-used in the manufacturing process.
- Water consumed (by quality/source) and targets for reduction.
- % water recycled compared with base year.
- Breakdown of energy used by source and comparison with base year.
- Efforts to introduce energy efficient or renewable energy resources.
- Energy saved due to conservation and initiatives to reduce energy consumption.

Resources

The Australian Government publishes a range of reports on water use and conservation initiatives at http://www.environment.gov.au/water/ including the Oct 2006 Water Efficiency Guide for use in building management.

http://www.environment.gov.au/settlements/chemicals/hazardous-waste/index.html has more information on waste and recycling.

Leading reporter

BHP Billiton 2010 Sustainability Report provides details of waste produced, recycled or sent to land fill. They also provide information on water recycled and re-used including targets for the future.

ENVIRONMENT

Other toxics, biodiversity, etc...

Why is it important to investors?

Under this category investors will seek to gain an understanding of other environmental risks and impacts relevant to the company. This could include a company's toxic emissions, its reliance or impact on ecosystem services and biodiversity, and its dependence or impact on other natural resources such as fisheries or forestry.

These issues are important because a company may rely on the environment for low cost environmental inputs or services. Failure of management to address these issues can:

- Inflate project costs and reduce profitability;
- Create or perpetuate health and safety issues;
- Increase risks and costs resulting from fines or sanctions;
- Create brand damage;
- Erode corporate culture;
- Inflict permanent damage on biodiversity; and
- Lead to accidents which may take many years to overcome.

Awareness of the need to handle dangerous materials appropriately and to avoid sanctions and fines is a useful indicator of the quality of management and the prospects of the company in years to come.

Commonly reported indicators

Investors look for:

- Hazardous waste emissions and reduction.
- NOx, SOx and particulate emissions.
- Emissions of ozone depleting substances by weight.
- Total water discharge by quality and destination.
- Details of toxic materials used in the manufacturing process.
- Strategies for managing impacts on biodiversity.
- Location and size of land use in or adjacent to areas of high biodiversity.
- Description of significant impacts of activities, products and services on biodiversity in protected areas.
- Habitats protected or restored.

Resources

The Australian Department of the Environment publishes materials and regulations on hazardous waste and its transportation: http://www.environment.gov.au/settlements/chemicals/hazardous-waste/

The Department of the Environment also has extensive information on biodiversity management: http://www.environment.gov.au/biodiversity/strategy/index.html

Leading reporter

The Orica website's Sustainability section contains details of programs to reduce toxic emissions and progress to date. BHP Billiton also includes useful information in its Sustainability Report.

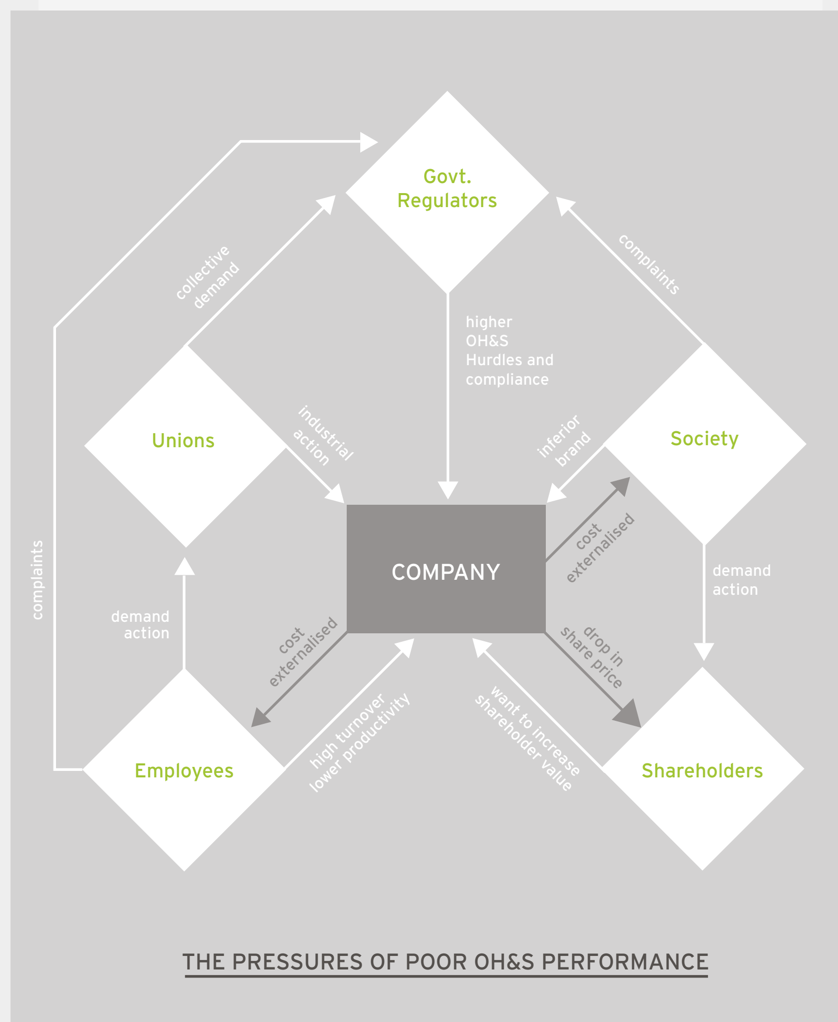
Why is it important to investors?

Workplace health and safety is a relevant investment risk because poorly managed it can:

- Create unnecessary costs for a business;
- Contribute to business disruption;
- Hinder staff attraction and retention in a tight labour market;
- Breach workplace regulation, and basic human rights; and
- Encourage increased regulation or regulator action.

High risk sectors often have a higher cost base in workers compensation premiums, safety equipment, and safety processes.

Good performance can reflect an efficient operation and quality management.



THE PRESSURES OF POOR OH&S PERFORMANCE

Source: AMP Capital Investors 2005

Commonly reported indicators

Investors look for both process safety and safety culture commentary and indicators. These should cover governance, process and performance.

Topic	**Lead indicators** (number or rate of...)	**Lag indicators** (number or rate of...)
Risk management and process indicators		
OHS Training	Training courses offered or held	Employees successfully **trained**
OHS Audit	Audits actually conducted	Audit (non-) conformances **detected**
Exposure monitoring	Monitoring conducted	Above limit exposures **detected**
Incident analysis	Incidents analysed	Risk controls **implemented**
Performance indicators		
Incidents / injuries	Number of near misses reported	• Lost time injury frequency rate (LTIFR) i.e. lost time injuries per million man hours • Total recordable Injury frequency rate recordable (TRIFR): i.e. total recordable injuries per million man • Fatalities • Severity rate: the number of lost days experienced as compared to the number of incidents experienced.
Post incident management	% of hazards rectified	

Sources: O'Neill, S, (2009), CFS GAM

SOCIAL

Workplace health and safety

Resources	Leading reporter
O'Neill, S, (2009) Best Practice OHS Reporting: http://goo.gl/IccDw AS/NZS 4801 is the Australian (and NZ) Standard for Occupational Health and Safety Management Systems: http://goo.gl/yGUOa Safe Work Australia has many free resources and tools: http://www.safeworkaustralia.gov.au Safe work Australia provides guidance on reporting: http://goo.gl/JpdPI Australian Petroleum Production and Exploration Association Limited Safety Incident Reporting Guideline 2005 (these guidelines are currently under review for release in 2011/12): http://www.appea.com.au/images/stories/Statistics/safety_incident_reporting_guidelines_-_march_2005_doc.pdf	Downer EDI Ltd reports year on year indicator data, along with the absence of fines or prosecutions. Commentary provides insight into safety governance to enhance risk management, and the responsibilities of business leaders. Performance and the area for performance improvements going forward is discussed, along with initiatives implemented which enhance business-specific risk management.

SOCIAL

Human capital management

Why is it important to investors?

Human capital management (HCM) is central to execution of business strategy, expansion, innovation, and business continuity, and is therefore a key area for investor attention.

The quality of HCM controls are particularly important for companies with significant intangible assets or in situations where skills shortages and competition for labour are clear risks. For all companies, strong HCM controls and practices contribute to employee productivity and loyalty.

Poorly managed HCM can lead to:

- Failure to meet strategic objectives and project targets;
- Poor morale and sub-optimal productivity;
- Inability to attract skills in tight labour markets / loss of key talent;
- Industrial disputation and poor employee relations; and
- Reputation damage

Commonly reported indicators

Investors look for both qualitative and quantitative indicators

Qualitative indicators:

- Board oversight of HCM.
- Integration of HCM and people risks into risk management processes.
- Executive remuneration linked to achievement of HCM objectives.
- Employee Diversity / anti-discrimination policies.
- Processes to monitor and address discrimination.
- Monitoring of employee satisfaction / engagement.

Quantitative indicators:

- Voluntary turnover rates
- Employee engagement / satisfaction (preferably externally measured with standardised framework).
- Rate of return from maternity/parental leave.
- Professional development training hours/employee.
- % women at Board and Senior management levels.
- Remuneration levels for male and female employees.

Resources

Global Reporting Initiative (Labour Practices and Decent Work): http://www.globalreporting.org

Leading reporter

National Australia Bank. Refer to NAB's 2010 Corporate Responsibility Annual review.

SOCIAL

Corporate conduct

Why is it important to investors?

Corporate conduct covers the manner in which the Board, management and employees of a company deal with each other, business partners, suppliers, customers, shareholders and the community. An example of poor corporate conduct is involvement in bribery and corruption.

The standard of corporate conduct is a relevant investment risk as poor corporate conduct can:

- Inflate projects costs and hence reduce profitability;
- Distort competition;
- Increase risks and costs resulting from prosecution;
- Create brand damage;
- Erode corporate culture;
- Distort allocation of capital across the broader market; and
- Restrict economic growth by perpetuating poverty.

Awareness of corporate conduct standards throughout the company's supply chain is also integral in understanding the associated investment risks.

High standards of corporate conduct can increase shareholder value as they reflect an organisation operating with integrity and transparency, consistent with high quality management.

Commonly reported indicators

Investors look for

- Corporate codes of conduct , the extent of their application and associated training.
- Responsibility within the organisation for the code of conduct.
- Linkages between remuneration policies and code of conduct.
- Commitments to external initiatives, how they compare with industry standards and whether these are voluntary or obligatory.
- Whistleblower policies.
- Procedures for monitoring and following up any breaches of the conduct code.
- Records of code breaches and the associated costs.

Resources

Transparency International publishes a range of reports on corruption in private and government sectors: http://www.transparency.org/

Extractive Industries Transparency Initiative (EITI) aims for natural resources to benefit all people: http://www.eiti.org

Leading reporter

RIO and BHP have published extensive code of conduct documents outlining their standards, who they apply to, membership of global transparency initiatives, whistleblower policy, staff training, reporting of breaches, etc.

SOCIAL

Stakeholder engagement

Why is it important to investors?

The extent to which a company engages with and accounts for its various stakeholder groups is a key factor in its overall performance from a sustainability perspective.

'Stakeholders' in this context include the company's shareholders and providers of capital, employees, suppliers, customers, public sector and regulatory bodies as well as the broader community. Engagement and communication with these stakeholder groups can deepen those relationships and reinforce the stability and value of a company.

Where companies gain stakeholder support through these methods, business success can be founded on an implicit community-approval of the company's operations, otherwise referred to as a 'licence to operate'.

Companies which effectively engage with their stakeholder groups stand to gain in the following ways:

- Improved reputation and brand support;
- Ability to attract and retain high quality staff;
- Differentiation in the market place;
- Improved access to in-bound investment, particularly investors with an ESG focus;
- Ability to identify costs savings through understanding how resources are used; and
- Better understanding of market trends and business opportunities.

Disclosure of a company's stakeholder engagement process is a means through which the company can inform its stakeholders and the broader investment community as to how they take into account stakeholder concerns in the core strategic management of the organisation.

Commonly reported indicators

Investors look for:

- Basis for identifying the key stakeholders with which to engage.
- Frequency of key stakeholder engagement.
- Engagement mechanisms e.g. meetings, surveys, briefings, use of on-line media.
- Main issues arising from stakeholder engagement.
- Steps taken to respond to stakeholder feedback.

Resources

The Global Reporting Initiative is a widely-used framework for sustainability reporting: www.globalreporting.org

Group of 100, "Sustainability: a guide to triple bottom line reporting" (2003) www.group100.com.au

Leading reporter

Westpac Banking Corporation is recognised by the Group of 100 as a leading practice reporter in the Financial Services industry sector.

Westpac has reported on stakeholder engagement in its 2010 Annual Review and Sustainability Report.

GOVERNANCE

Why is it important to investors?

Under this category investors will seek to gain an understanding of the company's governance practices. These practices provide insight into the quality of management in the company, and the quality of risk oversight by the board who are the representatives of shareholders.

Failure of the board to address these issues has contributed to many of the high profile corporate collapses over the past decade. Investors require reporting on corporate governance to better understand the framework, policies, and incentives in place to ensure best performance by the company.

Failure to report this information increases the risk of a company to investors.

Commonly reported indicators

Investors look for detailed discussion of:

- Risk management policies and implementation
- The Boards's assessment of related party issues.
- Director selection and board succession planning process.
- Information on board evaluation practices and director independence.
- The link between remuneration structures and company strategy.
- The link between remuneration structures and shareholder returns.

Resources

The ASX Corporate Governance Principles and Recommendations supplement black letter law in the Corporations Act in Australia : http://www.asx.com.au/governance/second-edition-revised-corporate-governance-principles-recommendations.htm

The Australian Council of Superannuation Investors publish Governance guidelines for listed company boards: http://www.acsi.org.au/corporate-governance-guidelines.html

The Financial Services Council also publishes a governance guide in relations to matters of Corporate Governance called Guidance Note No.2: Corporate Governance. A Guide for Fund Managers and Corporations: http://www.fsc.org.au/standards-guidance/financial-services-council-guidance-notes.aspx

Leading reporters

2010 – Remuneration reports – Caltex Limited, QBE Insurance and Tassal Group Limited

2010 – Risk and financial disclosures – Rio Tinto

5 CONCLUSION

The management of risk is an essential ingredient for the establishment of long term sustainable returns. The Global Financial Crisis, along with a number of recent individual company environmental and social events, once again reminded investors that investment risk covers a broad range of risk that effect the value of companies beyond financial risk.

This Guide aims to assist these companies with the view of investors on the information we need that will allow us to assess the company ESG risk which can then be used in short, medium and long term valuation processes. To date many companies have not disclosed this data so investors have had to make an assessment without the company view. This is not a satisfactory situation and we encourage all companies to look to their ESG risk disclosure.

Research on Sustainability Reporting Practices shows that more than half of the ASX 200 fail to provide meaningful information on their ESG risks. This Guide aims to assist these companies to begin their ESG reporting journey.

The Financial Services Council and the Australian Council of Superannuation Investors thanks the many individual, industry association and institutions that provided input into this guide.

www.acsi.org.au
www.ifsa.com.au