Practice Note

Time for CSR Reporting Standards?

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Samarco Mineiracoes, a 50-50 joint venture between Australia's BHP Billiton and Brazil's Vale, operates three iron ore mine in Mariana, Brazil. One of the dams burst on November 5, 2015, unleashing 62 million cubic metres of sludge into the Doce River at about 70km/h. It destroyed the town of Bento Rodrigues, killing at least 13 people, displaced thousands of others, affected water supplies to an estimated 250,000 people and killed fish stocks along 600 kilometres of river in two states.

Samarco, which has been fined 250 million Brazilian reals ($92 million) by Brazil's environmental watchdog, IBAMA, has agreed with the Brazilian government to put R$1 billion ($366 million) into a preliminary fund for compensation and clean-up costs, and risks additional daily fines of R$10 million ($3.7 million) if does not take steps to mitigate the ecological damage. In addition, a lawsuit filed in federal court in Brasilia seeks at least $7.2 billion that would be administered by a private fund over 10 years for environmental recovery and compensation. BHP shares have fallen 20 per cent since the dam burst.

It now appears that on-site engineers had warned BHP well in time that the Dams were unsafe. And certainly, none of these concerns appeared in BHP's Corporate Social Responsibility (CSR) Reports.

In an excellent article in *The New York Times* (reproduced in The Age Friday October 9 2015 Opinion p.28) Chris Tomlinson shows good evidence that corporates pick ethics best suited for them; and get away with it, as there is no auditing done of what they claim in their CSR reports. In fact, 93 per cent of Fortune 250 companies report how well they treat the environment. They promise that they care about our community, our future. But too often, these CSR reports are nothing more than public relations exercises with little substance.

Two recent cases highlight this. For years, Volkswagen's record for ethics and sustainability were exemplary; at least according to the company's CSR reports, says Tomlinson. Then, the world learned that the company was cheating on emission tests.

British Petroleum changed its name to BP in 1998 and soon began promoting that it was moving Beyond Petroleum. The company portrayed itself as the world's socially responsible large oil company. Then the Deepwater Horizon exploded, and the world learned how the company prioritised profits over safety.

Volkswagen's deception gives cynics another reason to be sceptical at the idea of mega-corporations balancing profit-making with protecting the environment and respecting societies expectations. But that shouldn't stop us, says Tomlinson, from demanding that corporations respect the social contract that they provide goods and services in a way that doesn't come with societal costs. But what is the legal or economic basis on which society can get corporates to listen? Do we have a big stick?

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There is a case that the shareholders in the companies should demand this because there is some research evidence that companies that respect environmental laws and society's expectations can generate more profits. Share portfolios consisting of companies that take environmental, social and governance issues seriously has been shown in some academic research to outperform benchmark indexes. Depending on the portfolio's risk profile, responsible companies can beat benchmarks by 1 per cent to 2 per cent, such research has found. Some of the reasons given for such observations are that waste and pollution increase costs and risks, while efficiency and cleanliness improve profitability. Consumers, particularly younger ones, also find responsible companies more appealing, which explains Volkswagen's and BP's marketing campaigns.

As such, one could argue that the shareholders could require corporations to report their attempts to minimise environmental impacts in a more transparent and meaningful way. Unfortunately, since all reporting is voluntary, there are no universal standards, and often only the most flattering data make it into company news releases. Therefore, it is up to trained finance professionals such as management accountants who have the tools and techniques to seek out the truth. Their CSR audit services would be invaluable to the many "Ethical Investment Funds" that have emerged in recent times; managing funds for investors who don't want to sacrifice their ethics to earn a high rate of return. These investment funds control trillions in assets under their management.

The problem is that there is always going to be fraud – companies that simply lie, and it's really hard to find that out before a disaster such as what BHP, VW and BP were involved in. Therefore, management accountants should read not only read corporate reports (sceptically); but also examine ASX and SEC filings, activist ratings and dozens of other sources before giving advice about ethical investment decisions.

The biggest problem for investors is the lack of a single international standard for comparing companies with their peers. Corporations pick and choose which standards they want to comply with, and they always choose the one that makes them look best. There are numerous organisations that offer ratings, but each has limitations. Even the ICMA, via its *Institute for the Advancement Corporate Reporting and Assurance (*IACRA) has a rating scheme called the *5-Star Rating scheme* which comes up with a single score that combines the Economic, Environmental, Social, Governance and Empowerment reporting of companies. Higher scores are achieved for the reporting of actual implementation and results in achieving an organisation's CSR objectives. However, this approach, like many others, are voluntary.

One effort to overcome this problem is the *Sustainability Accounting Standards Board*, a non-profit backed by former New York Mayor Michael Bloomberg, which has two former SEC chairs serving on the board. The group is drafting methods for measuring how well companies manage sustainability in 80 industries. The guiding principle is that sustainability is important to investors trying to make informed decisions. Once the board finalises the standards, the hope is the corporate and market regulator will require companies to include them in annual reports.

This would be a huge help to all investors, says Tomlinson, who want to compare corporations and decide which management teams are thinking about the long term, not just next quarter's profits. Corporations should also welcome a level playing field that compares apples to apples.