

**CLRA s229(1)(f)
Increased Transparency or the Emporer's New Clothes?**

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*"Through their own words
They will be exposed
They've got a severe case of
The Emperor's new clothes"*

- Sinead O'Connor

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1. Introduction

A child, however, who had no important job and could only see things as his eyes showed them to him went up to the carriage.

"He is naked," he said.

Hans Christian Anderson

Business is beginning to talk about its environmental performance. The community is listening...with a healthy dose of skepticism. Australia, like many first world nations, has moved well past a "trust me" mindset. We are no longer asking business to "tell me" about its environmental performance. We want business to "show me". We don't just want information, we want proof....

Despite the growing public pressure for companies to make environmental disclosures, and the efforts of some companies to provide environmental information voluntarily, environmental reporting standards in Australia to date have lagged behind those of other nations.

Australian Corporations Law has been revised in an attempt to respond to growing community demand for business to disclose its environmental performance. This paper explores why these changes have come about, and their potential impact. It also explores the framework of business controls necessary to support the credibility of information supplied to interested parties.

2. Recent Changes to Corporations Law

The Commonwealth Company Law Review Act 1998 (CLRA) received royal assent on 29 June 1998 and came into operation on 1 July 1998. Under s.299 (1)(f) of the CLRA, the directors' report of a company, registered scheme or disclosing entity for the financial years ending on or after 1 July 1998 must:

"if the entity's operations are subject to any particular and significant environmental regulation under a law of the Commonwealth or of a State or Territory - details of the entity's performance in relation to environmental regulation".

3. The CLRA changes in context

In order to understand why the CLRA changes have come about, it is necessary to understand the views of stakeholder groups within the community and the changes that these views are creating to the strategic landscape in the late '90s.

3.1 Stakeholders

The general public

The Australian general public remains concerned about environmental issues. A 1994 NSW EPA study revealed that 85% of respondents are concerned about environmental problems. Those surveyed did not regard all likely sources of environmental information as equally reliable. Environment or conservation groups were seen as reliable by 80% of the respondents. Half of those surveyed believed Government Departments. Less than one in four regarded environmental information from business and industry as reliable.

In summarising the findings of surveys over the last 20 years about Australians' attitudes towards the environment, Lothian (1994, pp78-99) concludes "the environment has remained a significant issue of concern to the community when compared to other issues".

Green activist groups and other Non-Government Organisations have been successful in harnessing and representing public concern about environmental issues and in many cases have become powerful voices for the environment in community and government decision making processes.

Government

Government is an important stakeholder in that it is responsible for making environmental law, and for enforcing it, at the Federal, State and Local level. Government is also ultimately answerable to the community. Government action on environmental issues therefore reflects the community's concerns.

Shareholders and fund managers

Shareholder 'activism' with respect to environmental and social issues appears to be on the rise.

Environmental and social performance is becoming increasingly important in investment decisions. The amount of funds invested in 'ethical investments' is growing. A recent study by Monash University revealed that 64% of the clients of fund managers and financial analysts have only financial objectives, while 31% said that their clients' objectives were primarily financial with some environmental and social considerations. 90% of fund managers and financial analysts surveyed had not received client requests for information about environmental performance of companies. However, this appears set to change in the future. 82% of those surveyed agree that environmental

concerns will become increasingly important for investment markets, and 65% believe that future dealing with environmental risks and opportunities is going to be just like any other financial risk and opportunity (Environmental Manager No.225, 1999). The increased interest from financial markets will become an important driver for disclosure of environmental information.

Shareholders are also willing to use their voice to ensure sound Board level governance. A recent example of this is a request by North Ltd shareholders for an Extraordinary General Meeting to consider the company's investment in the Jabiluka Uranium Mine. The shareholders asking the Board to commission a full independent report into the effect that Jabiluka would have on their investment. They were also requesting that a set of principles for responsible development be incorporated into the company's constitution. Significantly the suggested principles covered, amongst other things, "community and transparency" (Environmental Manager No 252, 1999).

Regulatory changes to corporate reporting requirements in response to shareholder 'activism' demanding improved corporate governance is not without precedent. Recently, the Australian Stock Exchange introduced listing rule 3C3(j) suggesting that the annual report cover "the Board's approach to identifying significant areas of risk and putting arrangements in place to manage those risks".

Business and industry

The general views of industry on environmental issues are well summarised by the Australian Industry Group. "Manufacturers want to comply with environmental regulations. They realise and agree their intent. Both the government and industry want to achieve the best in environmental protection. However, industry is faced with commercial reality on a day-to-day basis and wishes to achieve these targets agreed by the community and regulators, but at the lowest cost". (Doig)

In its guidance to industry on the CLRA changes, the Australian Industry Group (AIG) encourages a minimalist approach to compliance, suggesting that industry use "General Information and avoid excessive detail" and proposing "As a general rule, 1-2 pages would be towards the maximum length of the information to be disclosed". Although AIG acknowledge that compliance with the new requirement "is a chance to enhance Australian industry's environmental image", and provides guidance for more detailed, voluntary reporting, it does not go as far as encouraging more detailed reporting of environmental performance.

Effectively, the response of business and industry to the environmental debate has been, and continues to be, "We agree in principle, but we will argue the detail". While care needs to be taken to ensure that the most practical and cost effective measures are taken to pursue environmental objectives, industry and business must take care to manage the community perception that discussion about the details are in fact designed to frustrate the process and to delay or 'water down' implementation.

In recognition of community skepticism about the integrity of industry's response to environmental issues, some companies and industry bodies have taken a proactive approach and have plunged into the uncharted waters of Corporate Environmental Reporting. The resulting improvements in community consultation and performance reporting are beginning to raise community expectations with respect to responsible corporate behaviour.

3.2 The changing strategic landscape

Stakeholder demands are changing the strategic landscape of the late '90s. Some of the more important changes are described below:

Community right to know

Community Right to Know (CRTK) is now accepted right across the political spectrum as a basis for responsible legislative policy. CRTK has arisen as a response to sections of the community demanding more information about the environmental performance of industry and government.

Federally, CRTK has become the basis for the National Environment Protection Measure - National Pollutant Inventory (NPI). The NPI requires industry and government to provide information to the public regarding the emission of criteria pollutants. The States have been tasked with enforcement of the NPI, and the NEPM allows for naming non-reporters as a penalty for non-compliance. The community will also be provided information about the emission, by industry, of Greenhouse Gases under the Government's voluntary Greenhouse Challenge Program.

In NSW, the government has responded to community opinion by recognising "the fundamental right of the community to have access to information on emissions, including the risks that they pose for public health and amenity and the impact they have on the environment" (EPA NSW, 1997, p1). Most NSW licensees are required to report breaches of their licence conditions. The NSW Load Based Licensing Scheme will require companies to report their emissions of criteria pollutants in order to calculate licence fees. In October 1997 the NSW EPA published guidance to assist organisations in preparing Corporate Environment Reports (CER), however, there is no current legislative requirement to report environmental performance in line with these guidelines.

Different political agendas will accelerate or decelerate the pace of regulatory changes with respect to CRTK, but the movement will continue to be towards increased transparency.

Community consultation

Powerful business opinion leaders are beginning to advocate the value in effective and open stakeholder communication. This shift in business attitude (the cynical would argue that rhetoric is a more apt word) is typified in recent comments from Shell's chairman, Mark Moody-Stuart (McIvor, 1999).

Moody-Stuart is convinced that conducting business in an environmentally and socially responsible manner is in shareholders' long term interests. "And I believe shareholders generally, and [people at Shell] are interested in the long term rather than just the short term". Hence Shell's conversion to the sustainable development creed was a commercial decision. Moody-Stuart has encouraged executives to engage in open-hearted discussions with environmental action groups and other non-government organisations. "The real key to change is communication and listening. We must evaluate what society wants...and then work with a multitude of people to see whether we can move towards different solutions".

The changing face of company reports

Company reports are beginning to contain more environmental information. This change is being driven by factors that are external to the organisation, and from forces within.

Annual reports of companies traditionally provide the most readily available source of information about a company's performance and financial position. Some users of these documents, be they stockbrokers, shareholders, financiers, environmental organisations or the community at large, are coming to expect that the annual reports of companies will contain not only information on the company's financial position, but also details of its environmentally related activities and liabilities. The significance of these external demands remains debatable, but the growth is undeniable.

The recent CLRA changes are not the only mandatory environmental reporting requirements contained in Corporations Law. Existing environmental disclosure requirements include those relating to restoration obligations of extractive industries (UIG, 1995), and general reporting requirements under Schedule 5 relating to material contingent liabilities.

Those businesses moving to improved community relationships are recognising that the key to effective consultation is trust. These businesses are producing voluntary reports addressing the social and environmental impacts of their activities for the community's information and to promote dialogue.

Internationally, efforts are underway to develop guidelines for Corporate Environment Reporting (CER). Organisations at the forefront of developing these guidelines include the US-based Coalition for Environmentally Responsible Economies (CERES), Public Environmental Reporting Initiative (PERI), Global Environmental Management Initiative (GEMI), and the United Nations Environment Program (UNEP). Some industry bodies, including the Minerals Council of Australia, have included environmental reporting requirements in industry Codes of Practice.

International Standards for Environmental Management Systems (EMS) differ in their requirements with regard to public disclosures of environmental reporting. The Eco-Management and Audit Scheme (EMAS) requires public

disclosure (Brown, 1999, p1285). ISO 14001 (1996, s4.4.3), while requiring that an organisation should develop procedures to respond to communications from external interested parties, stops short of requiring any form of disclosure:

*"The organisation shall **consider** (emphasis added) processes for external communication on its significant environmental aspects and record its decisions".*

Integrated regulatory approaches

CER is becoming increasingly important with the adoption of more integrated approaches to environmental regulation. Australia is beginning to move away from traditional "command and control" legislative regimes, typified by the imposition of sanctions for transgressing broad ambient standards enforced through legislation and licences.

Contrary to common belief, elements of CER have long been part of the "command and control" approach. Most pollution control licences impose obligations on companies and their directors to disclose environmental incidents which have a serious or significant impact on the environment. Furthermore, the decision of the High Court in *Environment Protection Authority v Caltex Refining Co Pty Limited* held that the privilege against self-incrimination is not available to corporations. Stubington (May 1996) comments:

"...directors' duties in complying with environmental laws are really a sub-set of their duties more generally prescribed in Corporations law...The continuous disclosure regime in Coporations Law also makes it very clear that directors have to disclose information having a material effect on price or value. This must mean that where directors are aware of significant breaches of environmental laws which would impact on the value of their company, they would have a duty to disclose this to the marketplace".

Some more progressive jurisdictions are experimenting with economic instruments and pollution charges in an attempt to use market forces to improve environmental performance. Reporting of total pollutant emissions is a central mechanism of many economic instruments. The Load Based Licensing and Hunter Tradeable Salinity Credits schemes in NSW are examples.

Self regulation, supported by some organisations, is not widely recognised as an accountable method by regulators or the general community. Co-regulation, involving the formulation and adoption of rules and regulations in consultation with stakeholders, negotiated within prescribed boundaries is considered by both regulators and business as a more flexible and transparent approach with the potential for improved environmental outcomes (Jeffrey, 1999, p2.21). CER is a necessary centrepiece of this approach, as it relies on open, honest and frank dialogue between stakeholders, and accurate, credible environmental data.

4. Will the CLRA changes be enforced?

4.1 "Yes" - the case for...

In a media release issued on 5 November 1998, the Commissioner of the Australian Securities and Investments Commission (ASIC), Jillian Segal, warned that ASIC expects "companies will comply with the spirit as well as the terms of the law".

Peel (1998, p42) notes that enforcement provisions of the CLRA are contained in section 344, providing that directors may be liable for civil penalty orders under section 1317DA of the *Corporations Law* if they fail to take all reasonable all steps to comply. The consequence of a civil penalty order may be:

- a) to ban a director from managing a company; and/or
- b) to fine a director up to 2000 penalty points (currently a fine of around \$220,000)

ASIC, reinforcing their enforcement stance by way of Practice Note 68, have provided general guidance to assist directors in complying with the new requirements:

- *Prima facie, the requirements would normally apply where an entity is licensed or otherwise subject to conditions for the purposes of environmental legislation or regulation.*
- *The requirements are not related specifically to financial disclosures (e.g., contingent liabilities and capital commitments) but relate to performance in relation to environmental regulation.*
- *The information provided in the directors' report cannot be reduced or eliminated because information has been provided to a regulatory authority for the purposes of any environmental legislation.*
- *The information provided in the directors' report would normally be more general and less technical than information which an entity is required to provide in any compliance reports to an environmental regulator.*

4.2 "No way" - the case against...

The Democrats sponsored the amendments regarding environmental reporting with the intent of "encouraging and supporting" what a number of companies are already starting to do (Environmental Manager No. 207, 1998). However, regardless of ASIC rhetoric and the best intentions of the Democrats, it is arguable whether amendments, if considered in a vacuum will achieve their intent. Significantly, the potential enforcement of the amendments suffers from:

- a) a lack of political commitment; and
- b) uncertainty with respect to their practical application.

a) Politics

Senator Grant Chapman, chairman of the Joint Standing Committee on Corporations and Securities has publicly stated that the amendment came "out of left field" and that the committee had not even discussed the requirement. He described its inclusion in the Act as "inappropriate" and has indicated that the provision may eventually be dropped. ASIC's Practice Note 68 concedes:

"The requirements of s299 (1)(f) have been referred to the Parliamentary Joint Committee on Corporations and Securities for review. The Committee has not yet reported and any report is still to be considered by the Government."

The Government is still waiting for the Committee's report, although it is widely believed that political exigencies mean the mandatory reporting provision will remain.

b) Practical application

Another hurdle for enforcement is that the requirements are unclear. Craig Deegan, a leading Australian expert on corporate environmental reporting and a supporter of the amendment has described the wording as "sloppy" (Environmental Manager No. 208, 1998). The disclosure obligation appears to be limited as it only arises if the company's operations are subject to any "particular" and "significant" environmental regulation. The terms "particular" and "significant" are not defined by the regulation. Peel (1998, p42) has speculated that these terms refer to regulation of activities with substantial environmental risk, or those for which a specific legislative regime has been established. The types of environmental regulation in respect of which companies may be required to disclose environmental performance could include:

- licences or approvals
- environmental impact assessments
- the extent of land contamination associated with a company's business activities
- environmental audits (if required by legislation)
- environmental prosecutions

Freehill Hollingdale and Page partner, John Taberner, notes "I find the section really interesting in part because it doesn't have a verb" (Environmental Manager No. 245, 1999). It could be contended that it is difficult to comply with a legal provision if it doesn't contain an action word.

ASIC's Practice Note 68 concedes:

"ASIC is conscious that reporting practices in relation to environmental matters will evolve, particularly during the coming 12 months. ASIC will be monitoring reports to assess whether further guidance is necessary".

5. The future for environmental disclosure under Corporations Law?

Given the context of current developments in Australia, and the environmental reporting direction being set in other countries - the Danish EPA recently introduced legislation to make environmental reporting mandatory for particular companies and industrial activities (International Environment Reporter, November 1996, p 1078) - Peel (1998) predicts that in the future, the disclosure obligation may be extended to require reporting on performance in relation to environmental issues including:

- The environmental policies of the organisation;
- Emission levels for pollutants;
- Details of the environmental management system and waste management system of the company; and
- The level of capital expenditure by the company in relation to environmental initiatives.

Comprehensive environmental reporting of this nature would bring Australia into line with best practice environmental reporting standards internationally.

6. The advantages and disadvantages of CER

6.1 Why report? - the advantages...

Apart from the obvious advantage of avoiding punitive measures related to non-compliance with legislative requirements, the NSW EPA (October 1997) lists the following additional advantages of reporting:

- Satisfy the Community's Right to Know - publishing an environmental report demonstrates an organisation's commitment to protecting the environment and can promote confidence in the actions you are taking and in your risk management strategy. Proactive publication provides a measure of control over media and public reactions. Establishing credibility may help to reduce public concern in times of crisis.
- Create market opportunities - because Australia lags behind the rest of the world in environmental reporting, non-reporting may lead to a competitive and strategic disadvantage when it comes to ensuring world markets and investment opportunities. A small but growing number of consumers are choosing to buy environmentally friendly products. A public environmental report will help to establish your credentials in such markets. Additionally, some organisations are demanding that suppliers and contractors prove their environmental integrity.
- Gain access to funds and insurance - the financial and insurance sector is becoming increasingly concerned with the risk relating to organisations' environmental performance. Publishing the details of an organisation's environmental performance will help give a more accurate assessment of its risk profile and management, its prospects and worth, and may attract investment from ethical investment funds.
- Raise Staff Commitment - a public environmental report will raise the environmental awareness of employees and management, and provide them and their families information which may encourage commitment and promote pride in their organisation's performance.
- Strengthen negotiating powers with regulators and the community - CER may help companies set the agenda with regulators and the community by publicly setting out goals within a realistic timeframe. In the long term this strengthens business' argument for a more flexible regulatory regime.

6.2 Why report? - the disadvantages...

CER is not without its disadvantages. Indeed, the NSW EPA (October 1997) when promoting the merits of CER concedes "disclosing negative environmental performance does pose risks", and acknowledge the following disadvantages:

- Risk of penalty - the NSW EPA is "obliged to take seriously any evidence of licence breaches from a creditable source". However, a vague reassurance is given that where an organisation reports a licence breach, and has taken steps to fix the problem, "it would not be consistent with the prosecution guidelines to target (such) organisations".

- Loss of competitive advantage - some organisations will be concerned about losing competitive advantage by revealing confidential data. A tepid suggestion is offered in response... "you will need to balance this aim with your organisation's need to protect commercial information".

Other disadvantages are highlighted by Stubington (May 1996). These include:

- The growth, in the U.S., of potential litigators watching public registers of environmental information and company performance to ensure that the smallest slip-up is met by a prosecution.
- The development, in broad terms, of a societal fetish for over-disclosure which will result in risk averse practices that will stifle innovation and performance of companies.

7. So...how should business respond?

The move toward greater disclosure cannot be ignored. Either by the passing of legislation, or in response to public opinion and market forces, business must prepare for an age of greater transparency.

If an organisation's disclosures are to be credible, they should stand up to the scrutiny of interested parties. This scrutiny will only be favourable if the organisation is able to articulate how it effects control over its activities. The organisation should be able to demonstrate that it understands its environmental risks and is responding to these risks in an appropriate fashion. It should also be able to demonstrate the veracity of the information it is passing on to interested parties. An example of an effective business control model is outlined in Appendix A.

It is important that environmental management is accomplished within an integrated business control framework. Many organisations have made, and continue to make, the mistake of attempting to implement a stand-alone EMS. Environmental issues are core business issues and must be recognised as such, not an 'add on'. For this reason, any attempt to manage them outside of day-to-day business controls will not succeed.

The above steps are necessary in the CER process for the following reasons:

- They provide a verifiable audit trail for the information contained in the CER. This will be particularly important when environmental information contained in director's reports is subject to independent verification by auditors.
- The CER becomes the deliverable of a management process that includes consultation with stakeholders regarding their information needs and an understanding of environmental risk.

In addition to providing a robust basis for communicating with external stakeholders, adopting the above business control framework has the following advantages:

- It can be used as the basis for constructing a due diligence defence against environmental prosecution
- It is modeled on the "Internal Control - Integrated Framework" report of the Committee of Sponsoring Organisations of the Treadway Commission (COSO, 1992) - a widely recognised benchmark for effective corporate governance.
- It provides the basis for risk management statements made under the ASX listing rule 3C3(j) suggesting that the annual report cover "the Board's approach to identifying significant areas of risk and putting arrangements in place to manage those risks".
- It can be used to identify the risks, and benefits, posed by public reporting, and provide a basis for deciding what, and how, to report.

Finally, if an organisation chooses to produce a CER, it should provide a balanced view of the organisation's environmental performance. Public relations or 'greenwash' reporting will prove counter productive in the long term. In order to improve credibility and relationships with stakeholders, it is essential that the report be honest (NSW EPA 1997).

8. Conclusion

Corporate Environment Reporting is here!

The CLRA changes, considered in a stand-alone fashion may well have little effect. However, if considered in the context of the current business environment, they form part of a growing momentum for greater disclosure by business. Companies that are not yet 'on board' will, in the not too distant future, be dragged into the "show me" age by legislation and/or the overwhelming weight of public opinion and market forces. So business must prepare for an age of greater transparency.

So how should business respond?...

The answer is not to rush headlong into preparing a CER. A more appropriate response is to accept that environmental issues must be managed within a robust framework of business controls, and to recognise that an organisation's stakeholders should be consulted in the development of these controls. Business controls can then be focused on those issues that are of the most concern to the organisation and its stakeholders. As a result, the CER becomes the output of a management process that includes consultation with stakeholders regarding their information needs, based on a mutual understanding of environmental risk. Importantly, the credibility of the CER is enhanced by a verifiable audit trail and is able to withstand the scrutiny of auditors and of the "show me" generation.

Organisations failing to back up their environmental disclosures with a robust business control process, or omitting to consult stakeholders when preparing such disclosure, are flirting with the same public embarrassment as Hans Christian Anderson's Emperor. They will not be wearing the beautiful adornments of new age corporate responsibility. They will, in fact, be naked.

The Emperor realised that the people were right but could not admit to that. He thought it better to continue the procession under the illusion that anyone who couldn't see his clothes was either stupid or incompetent. And he stood stiffly on his carriage, while behind him a page held his imaginary mantle.

Hans Christian Anderson

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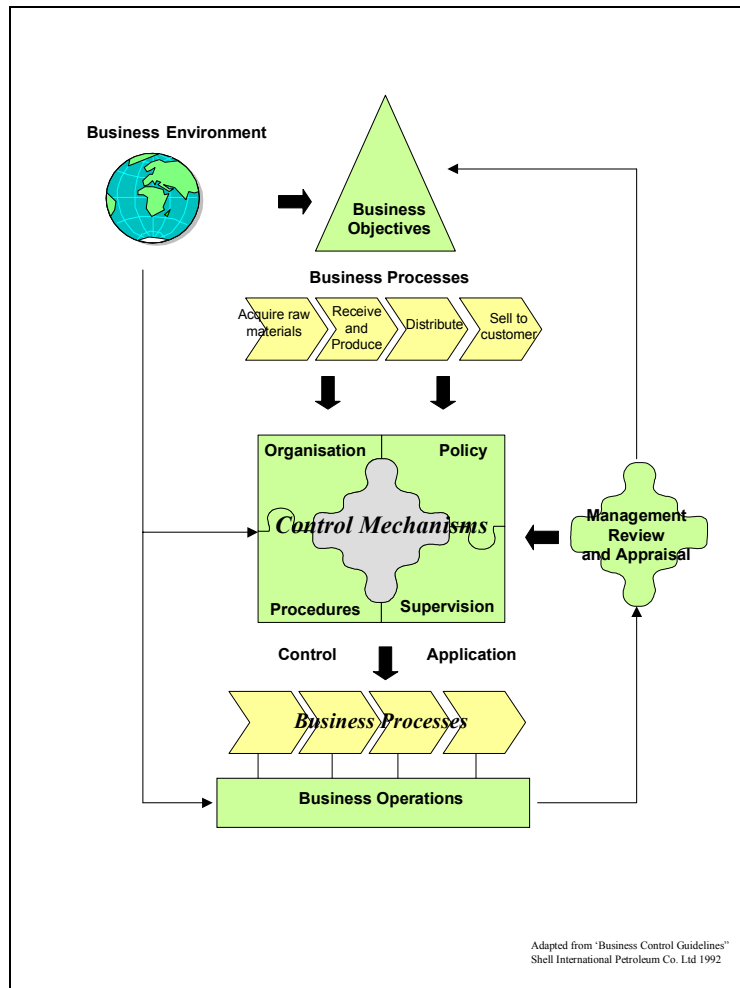
APPENDIX A

Discussing the Business Control Framework

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The framework outlined in this discussion paper provides a structure that can be used to organise business controls, and to describe their interaction, in a manner sufficient to deliver holistic risk management. The framework is based on a simple business control model (Figure 1).

Figure 1. - Business Control Model



The elements of a business control framework are described below. Effective risk management can only be achieved when all elements of the framework are delivered through establishing the appropriate business controls.

Element 1 - Policy and Strategic Objectives:

- Describe the organisation's vision of what it intends to be and its business objectives
- Describe the Policy framework that supports the business objectives, and within which the organisation works to achieve its business objectives
- Describe the controls for establishing and approving business objectives and Policies

Element 2 - Organisation Structure and Responsibilities:

- Outline the controls for maintaining and communicating current information about the current organisation structure
- Describe the roles and responsibilities of executive management committees
- Describe the controls for assigning accountability and authority to individuals.
- Describe the controls for communicating roles and responsibilities to all individuals within the organisation

Element 3 - Resources, Training, Awareness and Competence

- Describe the controls for planning and reviewing the sufficiency of human, physical and financial resources
- Describe the controls for assessing competence and awareness/training needs, and for developing training plans.
- Outline the awareness and training programs that are currently in place.

Element 4 - Risk Identification and Assessment

- Describe the controls for identifying and assessing risks.

Element 5 - Objectives and Targets

- Describe the controls for establishing objectives and targets that cascade from the overall business objectives, and include consideration of risk.
- Describe the controls for communicating business objectives and targets to individuals and cascading them into individual performance plans.
- Outline the quantitative indicators used to monitor performance towards achieving objectives.

Element 6 - Management Plans

- Describe the controls for establishing company-wide plans to achieve objectives and targets, and for cascading these plans into more detailed planning processes.

Element 7 - Emergency Planning

- Describe the controls for ensuring adequate preparedness for realistic emergency scenarios.

Element 8 - Legal and Other Requirements

- Define the legal and other requirements to which the organisation subscribes (e.g., requirements of shareholders, industry, International Standards, etc.)
- Describe the controls for incorporating legal and other requirements into business controls, for tracking changes, and for incorporating changes into business controls.
- Describe the controls for obtaining and renewing necessary licences and approvals

Element 9 - Documentation and Document Management

- Describe controls for managing business control documents throughout their lifecycle.

Element 10 - Operational Control

- Define the organisation's business processes.

- Describe the business controls to manage the organisation's business operations (e.g, accounting procedures, human resources procedures, operating manuals, etc.), including the controls in place to manage business processes undertaken by third parties (e.g., suppliers, contractors, distributors, franchisees, joint venture operations, etc.).

Element 11 - Communication and Reporting

- Identify internal and external stakeholders.
- Describe the controls used to achieve effective two-way communication between internal stakeholders at all levels, and with external stakeholders.
- Describe management reporting controls, and controls for reporting to external stakeholders.

Element 12 - Monitoring

- Describe performance monitoring controls.

Element 13 - Records

- Describe record keeping controls

Element 14 - Non-Conformances

- Describe controls for notifying, investigating, reporting and following-up on instances where performance does not meet established requirements (e.g., EHS incidents, quality non-conformances, breach of human resources procedures, breach of law/permit, etc.)

Element 15 - Audit

- Describe the controls for conducting audits and for audit follow-up.

Element 16 - Management Review

- Describe the controls for reviewing risks and controls, and for self attestation by management to confirm the status of controls.