Corporate Social Reporting

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A case for mandatory disclosure rules.

Broadly speaking, companies are the engine room of our industrialised economy and make a lot of positive contributions to modern society, but they also have enormous negative social impacts. Companies collectively employ millions of people. If a company collapses it arguably affects employees a lot more directly and acutely than investors, since employees have their undiversified human capital invested in their company. Companies with unsafe work practices kill and injure thousands of employees each year.[1] Companies manufacture and sell products. If they sell dangerous products this will directly and acutely affect consumers. Vivid examples are companies which sold products such as thalidomide and more recently the Dalkon Shield. Also industrial companies are pulling down our forests, mining our land and pumping out their toxic wastes into our rivers, oceans and sky.[2] Notable examples of horrendous pollution are the Exxon Valdez oil spill in Alaska and in South Australia the continuing problem of lead contamination of the air by BHP at Port Augusta.

These issues are critical and must be, and to some extent are being, tackled head on. The principal controlling device is substantive laws which directly regulate these matters. In Australia there are a vast array of laws designed to protect employees,[3] consumers[4] and the environment.[5] Without in any way derogating from this approach, mandatory disclosure rules have their part to play in the arsenal of weapons to tackle these problems.[6] Indeed such disclosure rules could complement these substantive rules.

Social information defined

There is a maturing corporate social responsibility movement which has defined corporate social responsibility as 'the impact of a company's activities on the welfare of a society'.[7] Corporations have a range of impacts on society which are traditionally broadly categorised according to the constituents they affect namely:

- *employees,* embracing such issues as health and safety, the physical and psychological working environment and equal opportunity.[8] Included in this category are issues such as sex discrimination, racial discrimination and 'sweat shops' which occur both locally and in developing nations;
- *consumers,* where the origin, quality, composition, suitability and safety of goods and services are important;
- *the community.* Corporations are part of the community and corporate activities impact on it. For example, companies often have business premises in a local community where most of their employees and their families live. Perhaps the most startling impact a company can have is in a smaller community where the company is the predominant employer and decides to shift its operations. Also a company's efforts at philanthropy and political donations (and even bribery!) are usually listed under this category; and

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- *the environment,* where manufacturing activities in particular can have a devastating effect.

It naturally follows that corporate social reporting is information on these topics. It is not surprising that the purpose of corporate social reporting is 'to establish and communicate the social impacts of business actions on those who are affected by them'.[9]

Is disclosure of social information warranted?

Whether disclosure of social information is warranted is contested ground. However, it is possible to justify social disclosures on the following bases:

- The basic norm of corporate law is profit maximisation in the interests of shareholders.[10] Therefore, voluntary, seemingly altruistic expenditures, are only acceptable so long as they can be justified according to the long-term profitability of the company. Arguably if directors choose to depart from a strict profit-maximising position they should report this information to shareholders and justify the expenditure, otherwise such expenditure is funds taken from the bottom line profit shareholders are entitled to. This will catch some forms of social information, notably positive acts that benefit constituencies other than shareholders. However, disclosure under this justification will not catch negative social impacts a company has in the normal course of conducting its business.
- Despite the basic profit maximisation norm, corporations are compelled to comply with the law even if corporate profits are thereby reduced. Arguably therefore, disclosure of a corporation's compliance with social-oriented laws is justified. Disclosure by companies of their compliance with the vast array of social laws would go a long way to providing adequate disclosure.
- Corporate social reporting provides relevant information to shareholders as investors. It is argued that a balanced degree of corporate social responsibility is a sign of a flexible, sensitive and responsive management style that results in higher profitability[11] and there is a link between social responsibility and long-term planning.[12] A view to the long term is generally viewed as a sign of good management.
- The interests of other stakeholders in corporations or as a matter of public policy. Since a corporation's social behaviour principally affects people other than shareholders (namely employees, consumers and the public generally) this is a particularly compelling argument.[13]

Mandatory disclosure laws

The Corporations Law and the regulations made thereunder do not explicitly require disclosure of any social information. Disclosure of some social information may occur in the financial statements or the notes to them. Some socially oriented behaviour of corporations has a financial impact and, therefore, disclosure of this will appear in the financial statements. It is in the more detailed regulation of the accounts, particularly the Accounting Standards, that disclosure of three types of social information arises. These accounting rules require disclosure of employee entitlements, restoration costs in the extractive industries and contingent liabilities. Liabilities of a social nature, such as environmental litigation or warranty claims for faulty products, will often be contingent liabilities and, therefore, would have to be disclosed in this way.

As all of these three potential disclosures occur in the financial statements, they are subject to the usual requirement that the amounts involved be material. Therefore, in public companies with very large market capitalisations, it is likely that only very significant social events will have to be disclosed in the accounts. It is strongly arguable that these matters are so important that they should not be bounded by the materiality requirement. This certainly is the approach adopted in the US concerning disclosure of environmental litigation involving a government authority.[14]

Besides disclosure in the financial statements there are two other ways disclosure of social information may arise. First the director's report must describe the corporation's business and any significant changes to the company's operations during the financial year, after balance date (up until the time of the report) and in the future (although this is optional). These are very general requirements that do not specifically require the disclosure of any social information. However, if a particularly significant social development arose it may have to be disclosed under these requirements. Only particularly noteworthy developments would need to be reported since the threshold is 'significant change' or 'significant affect'. Second, particularly pertinent social information may need to be disclosed under the continuous disclosure regime.[15] However, disclosure is only required of material events so the same argument of materiality of financial information (as above) is relevant.

As is self-evident from this description, the current mandatory disclosure requirements are very piecemeal and limited. In contrast both the UK[16] and the USA[17] require some corporate social reporting to shareholders.

Voluntary disclosures — empirical studies

Despite only very limited corporate social reporting obligations in Australia some companies are sensitive to and voluntarily disclose some social information. There have been a myriad of empirical studies undertaken of social reporting by companies. It is not feasible to summarise all of these studies in this article.[18] I recently undertook a study of social disclosures by corporations in 1995. I reviewed the reports mentioned below for fiscal year 1995 of the top ten listed companies in Australia and the US. In Australia the corporate fiscal year is commonly from 1 July to 30 June, whereas in the US it is commonly the calendar year. My study was for Australian companies of the 1994–95 fiscal year, although one company had a calendar financial year and another's fiscal year was from 1 October to 30 September. Those reports were:

- for Australian corporations, the annual report to shareholders and notice of the AGM; and
- for US corporations, the annual report to shareholders, the Form 10-K and the proxy statement for the AGM.

Restricting the study to the top ten corporations results in a limited sample. However the hope is that these corporations would and could afford to implement the best social disclosure practice available. This hope is supported by the findings of previous studies.[19]

The results of my study are summarised in Table 1 below.

All companies in the sample made some disclosure about their employees. Thereafter, disclosures of the environment and community involvement were roughly the same. This is explained by the increased importance the environment has as a social issue.

The most common methods of disclosure were by narrative disclosure and monetary statistics. Most corporations adopted a combination of both methods. Noticeable also is the high number of disclosures by US corporations of their compliance with legal requirements (and the complete absence of this method in Australia). In the US the most common such disclosures were compliance with environmental laws followed by a small number of disclosures about compliance with product standards, labelling laws and equal opportunity legislation. These types of disclosures occurred in the Form 10-K under the heading Description of Business, Management, Discussion and Analysis, and Legal Proceedings or in the proxy statement pursuant to shareholder requisitioned resolutions. So such disclosure is almost always only made by the authors of these documents when required by mandatory disclosure rules.

Type of social data disclosed	Australia	USA
	Companies making disclosure[20]	
Employees	10	10
Consumers	3	6
Energy	1	4
Environment	6	9
Community	8	8
Other	5	5
Method of information disclosed	**Number of disclosing companies**	
Narrative	10	10
Statistical (monetary)	9	10
Statistical (non-monetary)	3	6
Comparison with social indicators	0	0
Legal compliance	0	6
Social balance sheet	0	
Extent of disclosure (pages)	**Number of disclosing companies**	
1-2.5	4	0
2.5-5	4	1
5-7.5	2	2
7.5-10	0	2
Greater than 10	0	5
Bad news	**Number of disclosing companies**	
Employees	2	5
Consumers	1	4
Energy	0	1
Environment	2	7
Community	0	1
Other	2	0

The amount of disclosure made by corporations in my study is significantly higher than in previous studies. This is consistent with the recognised trend to increased disclosures over time.[21] However, this is where my sample from the top 10 companies may not be particularly representative. Also, the US statistics, which are particularly high, are inflated to the extent that not all companies fully utilised the integrated disclosure regime. So some companies made the same or very similar disclosures in both the 10-K and the annual report to shareholders and both were counted in my study. In addition, all of the US corporations referred in their annual reports to special documents dedicated to aspects of their social policies and performance. These documents were often quite lengthy but were selective and painted a picture very favourable to the corporation. Only one Australian corporation referred to such a report (which was incomplete at the time the annual report was published).

Disclosure of bad news was almost exclusively only reported because the disclosure laws mandated such disclosure. In Australia this was principally under disclosure of contingent liabilities. However, one case seems to have been voluntary, but may have been reasonably notorious in any event (reporting the deaths of several miners). There is some empirical evidence which supports this contention, at least when the media give widespread coverage to the issue.[22] In the US disclosure of bad news appeared under several categories because laws required such disclosure. This practice strongly points to the need for mandatory disclosure rules if social disclosures are considered to be important and serious.

The protean concern arising from my and other studies is the tendency of corporations to only report good news. For example, existing practices indicate a difference between a company's actual environmental performance and its disclosure on this topic.[23] This is most telling even when it has been established that there is bad news to report (successful prosecution for breach of environmental laws) but there is no disclosure of this in the annual report (although positive disclosures increase).[24] There is even evidence of significant disparity of the type of disclosures made by companies in the same industry which were under the same compulsory disclosure rules and would be likely to be subject to the same types of liabilities under environmental laws.[25] Many companies do not make any disclosures, in clear contravention of the law. Those companies which did make a disclosure often provided inadequate information to enable readers of the information to make rational decisions.[26] The general consensus is that corporate social reporting degenerates into a public relations exercise that reveals very little of companies' true social performance.[27] Another risk is that reporting will be spasmodic (in particular there is evidence that the 'luxury' of corporate social reporting decreases during an economic recession).[28] Also industry type and the role of environmental lobby groups can 'pressure' particular companies into voluntary disclosures in an attempt to legitimise themselves. The conclusion is that current disclosure practices are woefully inadequate. The disclosures made certainly cannot be regarded as high quality when measured against criteria of accuracy, credibility, completeness, etc.

This conclusion itself points to the need for mandatory and comprehensive corporate social reporting. Corporations are using the lack of mandatory regulation to attempt to manipulate information about their true social performance which deflects potential criticism and activism. There are many models for how corporate social reporting can and should be done.[29] None of these are necessarily easily implemented or entirely satisfactory on their own. However, if some form of mandatory corporate social reporting is implemented then, over time, it will mature and become increasingly sophisticated. Hopefully, corporate social reporting will become more comprehensive, comparable and thus less prone to manipulation. Over time it is possible to observe the same happening with financial accounting which is continuing to mature, particularly with the evolving body of rules set

out in the accounting standards. My hope, based on this observation, is that corporate social reporting will similarly mature and evolve. However, the necessary next step is to make corporate social reporting mandatory. As a voluntary exercise it will simply languish as a public relations tool, rather than being a serious obligation for which corporations and managers should be accountable.

The first, tentative step down this path has now been taken. *The Company Law Review Act 1997* (Cth) was amended in the Senate at the instance of the Labor party and the Democrats. The amendment alters the *Corporations Law* by obliging directors to provide in their annual report:

> 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. [s.299(f)]

This amendment does not apply to financial years ending on or before 1 July 1998. The first disclosures will occur for the 1998–99 financial year with annual reports usually appearing in October and November. This delay is frustrating but is appropriate as many companies will have to implement environmental compliance programs in order to be able to comply with this legislation. It will be interesting to see which environmental regulations will be regarded as 'significant' and which as insignificant! (Is there such a thing as an insignificant environmental regulation?) Compared with the range of topics corporate social reporting can cover, this amendment must be regarded as a very piecemeal approach to corporate social reporting. It is welcomed as a first step but hopefully one step down a long path that will be fully trod. However, this topic remains a political football. Despite agreeing to the amendments to ensure the Act was passed and passed on time, the Government has since announced that it opposed this amendment (and some others). It has referred these matters to the Parliamentary Joint Committee on Corporations and Securities. The very real prospect is that this new provision may be repealed prior to it being operative![30]

References

1. Berns and Baron, *Company Law and Governance: An Australian Perspective* Oxford University Press, 1998, pp.114-5. The authors document the role of corporations with the industrial diseases associated with contact with asbestos.
2. For a description of how companies have negative environmental impacts see Freedman, 'Accounting and the Reporting of Pollution Information', (1993) 5 *Advances in Public Interest Accounting* 31 at 31 to 32.
3. *Safety Rehabilitation and Compensation Act 1988* (Cth); *National Occupation Health and Safety Commission Act 1985* (Cth); *Occupation Health and Safety Act 1986* (SA); *Workers Rehabilitation and Compensation Act 1986* (SA).
4. *Trade Practices Act 1974* (Cth); *Fair Trading Act 1987* (SA); *Consumer Transactions Act 1972* (SA); *Sale of Goods Act 1895* (SA); *Consumer Credit (South Australia) Act 1995* (SA) (which incorporates by reference the new *Consumer Credit Code*).
5. *World Heritage Properties Conservation Act 1983* (Cth); *Environment Protection (Impact of Proposals) Act 1974* (Cth); *Environment Protection (Nuclear Codes) Act 1978* (Cth); *Environment Protection Act 1993* (SA); *Native Vegetation Act 1991* (SA); and *Soil Conservation and Land Act 1989* (SA).
6. See generally Fisse and Braithwaite, *The Impact of Publicity on Corporate Offenders*, State University of New York Press, 1983.
7. Henderson and Peirson, *Issues In Financial Accounting*, Longman Cheshire, 1994, 6th edn, p.872.
8. Gray, Owen and Maunders, *Corporate Social Reporting*, Prentice Hall, 1987, Ch. 6.
9. American Institute Of Certified Public Accountants, *The Measurement Of Corporate Social Performance*, AICPA, New York, 1976, p.6.
10. Clark, *Corporate Law*, Little Brown & Co., 1986, p.6.
11. Bowman and Haire, 'A Strategic Posture Toward Corporate Social Responsibility', (1975-Winter) 18 *California Management Review* 49 at 54 and 57.
12. Trotman and Bradley, 'Associations Between Social Responsibility Disclosure and Characteristics of Companies', (1981) 6 *Accounting, Organisations and Society* 355.
13. Tolmie, 'Corporate Social Responsibility', (1992) *UNSW Law Journal* 268 at 270.
14. *Securities Exchange Act 1934* (US), Regulation S-K item 103, instruction 5.
15. Australian Stock Exchange, Listing Rule 3.1.
16. Guthrie and Parker, 'Corporate Social Disclosure Practice: A Comparative International Analysis', (1990) 3 *Advances in Public Interest Accounting* 159 at 166-7 where the authors state: 'For example, the following disclosures must be made by corporations in the Directors Report section of their annual report to shareholders:
    - Charitable donations (*Companies Act 1967*, s.19)
    - Political donations greater than £200 (*Statutory Instrument* 1055 of 1980)
    - Disabled employee policy (*Health and Safety at Work Act 1974*; *Employment Act 1982*, s.1)
    - Conditions of South African workers (Required by Board of Trade as per code of conduct for companies with an interest in South Africa [1978])
    - Employee consultation and communication policy (*Employment Act 1982*, s.1).'
17. Brown, *The Regulation of Corporate Disclosure*, Aspen, USA, 1995, 2nd edn, ch. 2; Boehm and Smith, 'SEC Environmental Disclosure Requirements: The Hazards for Issuers, (1992) 3(1) *Journal of Corporate Disclosure & Confidentiality* 5 at 29-31. In addition to the general requirement for a management discussion and analysis, particular disclosures must be made of compliance with environmental laws (*Securities Exchange Act 1934* (US) Regulation S-K item 101) and enforcement action by a government agency of environmental legislation (*Securities Exchange Act 1934* (US) Regulation S-K item 103).
18. See generally Gray, Kouhy and Lavers, 'Corporate Social and Environmental Reporting: A Review of the Literature and a Longitudinal Study of UK Disclosure', (1995) 8 *Accounting, Auditing and Accountability Journal* 47.
19. Trotman and Bradley, 'Associations Between Social Responsibility Disclosure and Characteristics of Companies', (1981) 6 *Accounting, Organisations and Society* 355.
20. All statistics relate to the number of companies making such disclosure.
21. Deegan and Gordon, 'A Study of the Environmental Disclosure of Australian Corporations', (1996) 26 *Accounting and Business Research* 187 at 191; Deegan, 'Environmental Reporting in Australia: We're Moving Along the Road, But There's Still a Long Way to Go' paper presented at a staff seminar at the School of Commerce, University of South Australia, 29 May 1998 (author on file) who notes increased level and quality of environmental disclosures by mining companies in the last few years.
22. Deegan, Rankin and Voght, 'Firms' Disclosure Reactions to Major Social Incidents: Australian Evidence' paper presented at a staff seminar at the School of Commerce, University of South Australia, 29 May 1998 (author on file).
23. Freedman and Wasley, 'The Association Between Environmental Performance and Environmental Disclosure in Annual Reports and 10Ks', (1990) 3 *Advances in Public Interest Accounting* 183.
24. Deegan and Rankin, 'Do Australian Companies Report Environmental News Objectively? An Analysis of Environmental Disclosures by Firms Prosecuted Successfully by the Environmental Protection Authority', (1996) 9 *Accounting, Auditing and Accountability Journal* 50 at 59.
25. Freedman and Stagliano, 'Disclosure of Environmental Cleanup Costs: The Impact of the Superfund Act', (1995) 6 *Advances in Public Interest Accounting* 163 at 170.
26. Freedman and Stagliano, above, at 170-1.
27. Cowen, Ferreri and Parker, 'The Impact of Corporate Characteristics on Social Responsibility Disclosure: A Typology and Frequency Based Analysis', (1987) 12 *Accounting, Organisations and Society* 111 at 113 and 121; Deegan, 'Environmental Reporting for Australian Corporations: An Analysis of Contemporary Australian and Overseas Environmental Reporting Practices', (1996) *Environmental and Planning Law Journal* 120 at 123.
28. Gray, Owen and Maunders, above, pp.92-3.
29. Gray, Owen and Maunders, above, point to five models.
30. The matter is currently open for comment to the Parliamentary Joint Committee on Corporations and Securities, Suite SG. 60, Parliament House, Canberra, Canberra, ACT, 2600 (tel 02 6277 3583).