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AIBE Industry Research Series

The Future of Corporate Reporting

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CONTENTS

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Executive Summary

Rapid developments are occurring in the corporate reporting environment globally with implications for regulated and voluntary reporting in Australia of which the business community needs to be cognizant. Corporate reporting has the potential to contribute significant value to organisations as well as effect meaningful change for society and the environment. However, the competitive implications for organisations failing to address such reporting expectations are already evident and will become increasingly significant in the coming years.

This AIBE Industry Research Series report brings together opinions from a range of corporate reporting experts from Australia and around the world to provide a picture of the current state, and predictions for the future of corporate reporting. Four themes are identified which look set to influence the future of corporate reporting. In addition, two topics emerging globally which appear highly relevant for the future corporate reporting agenda in Australia are discussed. Finally, the report outlines the implications of these changes with recommendations for the Australian business community.

Current Trends in Corporate Reporting:

- Stakeholders are becoming increasingly savvy and organised in pursuing their demands for greater levels of non-financial information;
- A key shift towards dependency thinking as opposed to impacts is occurring; This incorporates a gradual trend towards context-based or landscape-based sustainability measures as opposed to incremental impact improvements;
- Supply chain transparency and accountability will continue to be a focus of stakeholder expectations, and has the potential to be transformed by new technologies;
- The integration of multi-level reporting developments, such as international policy and national government reporting initiatives is likely to increase in coming years with potentially significant implications for organisations
- Income inequality and biodiversity loss have the potential to be the next focus areas for corporate reporting disclosure and potentially regulatory reform in Australia.

What does this mean for business:

- Expect further developments in corporate reporting as the area continues to evolve.
- There is a need to understand changing non-financial disclosure expectations and for organisations to set out their strategy to cope. Experts warn failing to address such changes will result in significant reputational and financial risks.
- Many experts, even those supportive of emerging corporate reporting practices, argue more fundamental changes are required in terms of the legal requirements of business to ensure the planet can move to a sustainable future;

Corporate Reporting

In the last five years alone, much has changed in the corporate reporting landscape. Numerous small tangible steps towards more comprehensive and meaningful corporate reporting are occurring around the world with implications for Australian organisations.

There are signs that such changes, while seemingly insignificant, will create substantial shifts in certain facets of the corporate agenda and every day operations of organisations. Figure 1 shows a selection of significant developments in the corporate reporting space.

This Australian Institute for Business and Economics (AIBE) Research Impact Series Report focuses on informing organisations of some of the most pressing developments in corporate reporting, offering expert insights from world leading authorities and academia. Four prominent trends in corporate reporting are outlined, leading to suggestions of future focal points, namely, income inequality and biodiversity loss. Implications for Australian businesses along with recommendations to manage the many changes to corporate reporting requirements are provided.

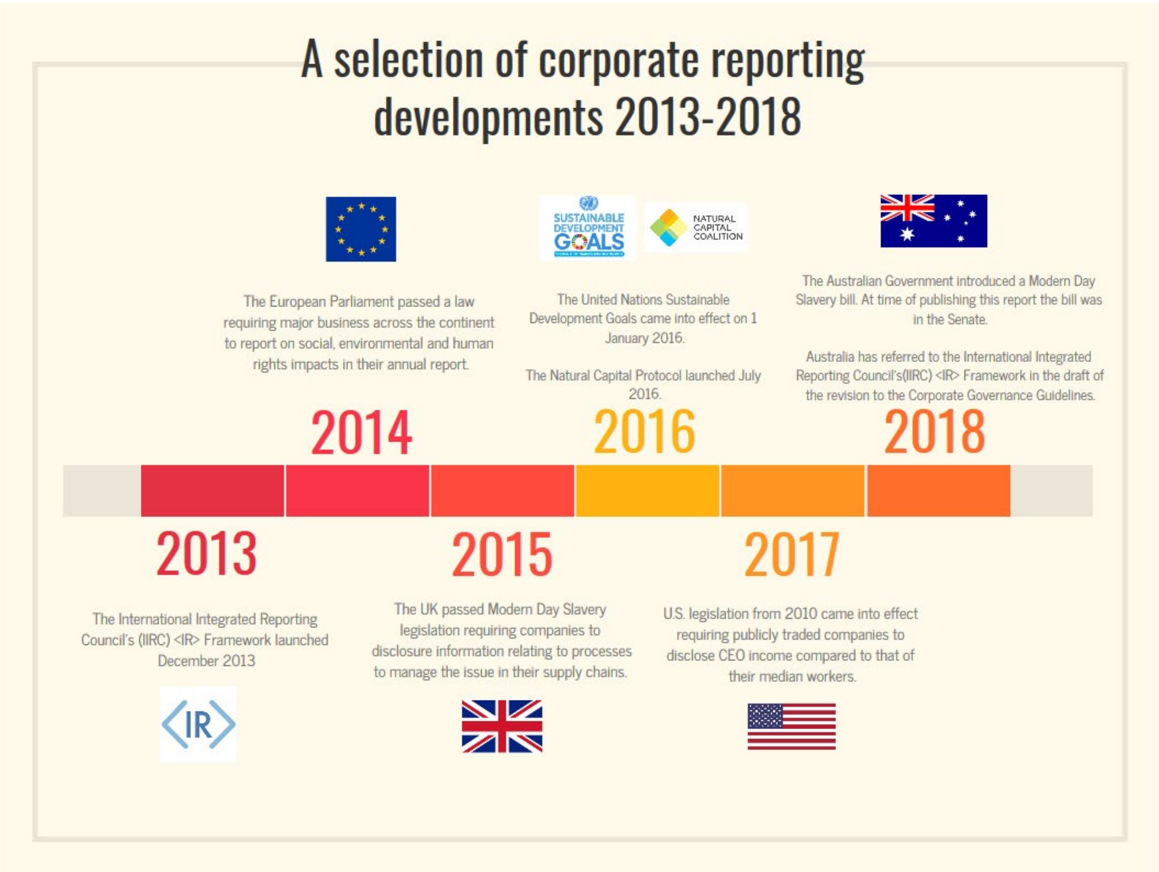


Figure 1. A selection of corporate reporting developments 2013-2018

Current Trends

A number of key trends are appearing across the corporate reporting environment. What many have traditionally considered 'sustainability reporting' is now arguably becoming mainstream. While organisations are increasingly providing non-financial information, the level and quality remains insufficient to meet needs of internal and external stakeholders as witnessed in the four identified trends in this report. Indeed, a recent report by KPMG found 50% of ASX200 company reports include non-financial performance narrative and 70% report material risks[1].

Despite this, the important step of linking such risks to the strategic objectives of the organisations or drivers of value remains extremely limited at just 3%[2]. Evidence of this point can be seen in the expert opinions and recent developments around the world.

Corporate Reporting Current Trends

Stakeholders are becoming increasingly savvy and organised when seeking non-financial disclosures

Emerging focus on organisational dependencies (as opposed to impacts)

Supply chain transparency and accountability pressure continues & may be transformed by new technology

Integration of multi-level reporting developments will have implications for corporate reporting

Figure 2. Current Trends in Corporate Reporting

Stakeholders are increasingly savvy and organised when pressuring organisations to disclose data

Stakeholders hold significant influence over organisations and in recent years this has become more evident. Three such stakeholders who feature prominently in discussions with experts include investors, regulators and legislators.

Increasing investor demands

Investors are coming together through groups such as the CDP (Investors and purchasers worth more than US$100 trillion)[3] and the United Nations Principles for Responsible Investment (PRI) (approximately US$80 trillion of assets under management aligned)[4] to use their combined power to seek greater non-financial disclosure from organisations.

The importance for the investor community is clear, particularly impact investors and institutional investors such as superannuation / pension funds. If their portfolios are to deliver value over many decades they require information relating to the exposure or risk of organisations to long-term phenomena such as climate change, deforestation and water scarcity.

Investors are the big chance – the big pension funds around the world are actually becoming quite involved and are putting a bit of pressure on the companies, in governance as well as sustainability reporting and that will have an effect in due course because they control an awful lot of funds.

Ian Mackintosh, Chair Corporate Reporting Dialogue

So what are investors looking for? In general, sustainability, governance and value, however, the exact details depend on the investor or group acting on their behalf. CDP asks for GHG emissions, water, forests and supply chain related disclosures[5]. Some of the experts we interviewed argue the SDGs are now driving changes in the questions investors are asking.

The major asset owners of the world have all signed up to the UN PRI.

Professor Mervyn King, Chairman IIRC

I think the important piece you're seeing now here is the investors are now actually demanding it, so you're seeing the long-term investors like superannuation funds are very much involved in driving the discussions so .....prioritising for the investor what it is that you're doing to protect value over time.

Nick Ridehalgh, Partner KPMG

Regulatory and legislative reform

Globally, regulatory bodies and governments are increasing requirements for organisations to provide non-financial information to stakeholders such as risks to operations associated with climate change, modern day slavery, how multiple capitals relate to the value creation process of the organisation and most recently income inequality.

Discussions are also occurring as to the potential for accounting standards, a point many experts argue is necessary for more systemic change. For example, the recently released Green Paper by Oxford Professor and Head of the Accounting Department Richard Barker and Oxford Visiting Professor Bob Eccles, Should FASB and IASB be responsible for setting standards for nonfinancial information?[6]

One emerging regulatory change involves **The International Integrated Reporting Council's (IIRC) <IR> Framework** which has now received regulatory signposting in more than 16 countries[7].

The extent the framework features in regulations differs between countries, for example, in South Africa Integrated Reporting is required, in the United Kingdom it forms part of the Strategic Report and in New Zealand the IR Framework is referred to in the Corporate Governance guidelines.

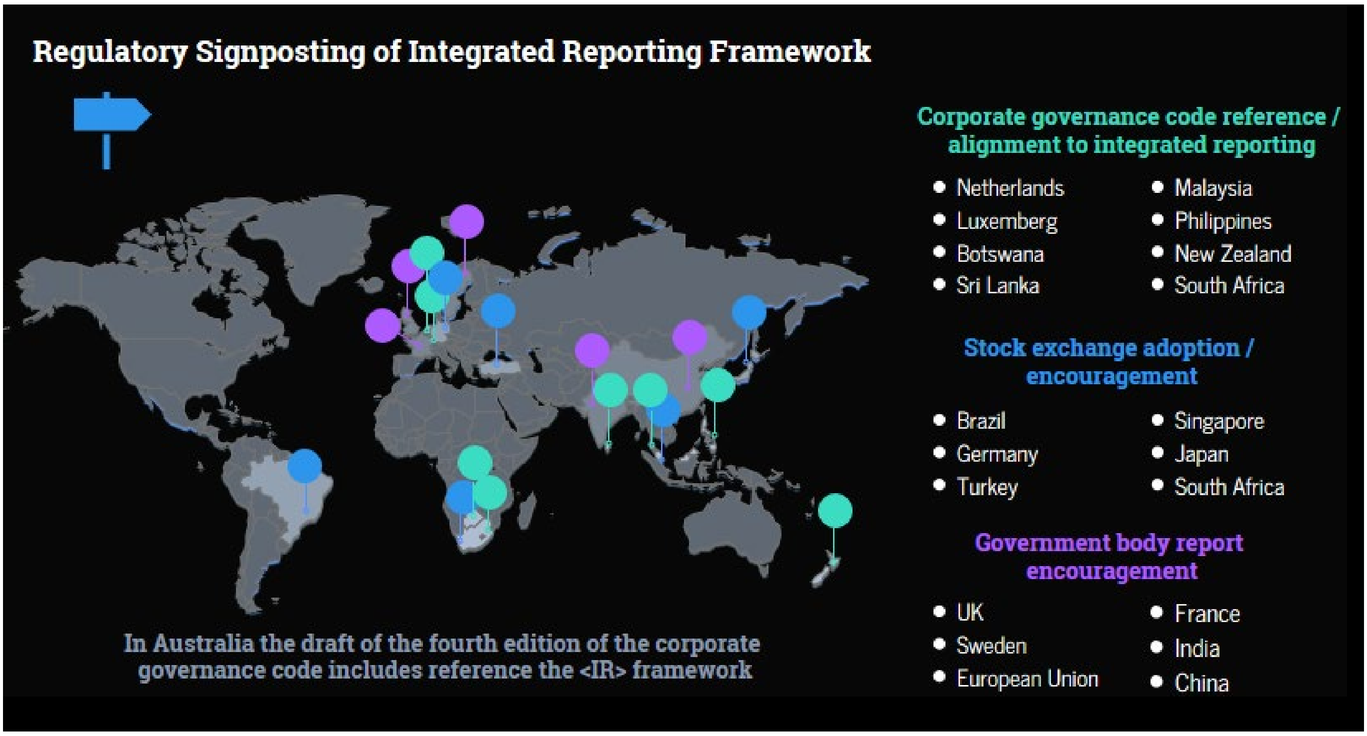


Figure 3. Regulatory signposting of IR Framework (Adapted from [8] pp6-7)

A number of interesting developments are also occurring in legislative reform globally. **Modern Day Slavery** has emerged as a focal point with the introduction of legislation in the United Kingdom in 2015[9], following The California Transparency in Supply Chains Act of 2010[10].

A less prominent development is the emergence of **Income Inequality** reporting. A 2010 bill in the United States requires companies to disclose the difference between the CEO salary and the average salary of all other staff with the first reporting of such data released earlier this year (2018). The results were a revelation with the highest ratio of 4,987 : 1 in salary between the CEO and average worker[11].

This new form of corporate reporting attracted condemnation of a number of companies[12]. While reporting this one metric in and of itself does not change behaviour, stakeholder pressure is now forcing this issue to become an important consideration for organisations.

Apart from customer, NGO and investor pressure related to the data and negative media following the reporting, a number of states have passed or are in the process of attempting to pass laws relating to taxes and tendering consequences based on a company's CEO to average worker income ratio.

In Portland, Oregon an additional tax surcharge of 10% is placed on organisations with a ratio of more than 100 : 1, and a 20% surcharge of those with more than 250 : 1. Such taxes are unprecedented as they are argued to be the first of their kind to target inequality[13]. A similar state bill in California was narrowly defeated and again further bills are proposed at the Federal level, by the city of San Fransisco, and States including Minnesota, Rhode Island, Connecticut, Illinois, and Massachusetts.

An alternative route taken by some parts of the United States relates to eligibility to tender for government funded work, with a proposed bill in Rhode Island seeking to give preferential treatment to companies with a ratio of no more than 25 : 1[14]. Combined, these developments reflect the importance of the issue of income inequality across the United States and the potential for further consequences for organisations associated with their actions to address the issue.

The Sustainable Development Goals have become sort of an organising framework for the investment community, companies are kind of sort of starting to respond to that, it's another thing that has reporting implications.

Professor Bob Eccles, Oxford

Regulatory and legislative reform in Australia

Regulatory and legislative reform is also taking place in Australia relating to non-financial company reporting, specifically climate change risk disclosures, modern day slavery, organisational values and an organisation's social licence to operate.

The Corporations Act 2001 (Cth) supported by Regulatory Guides 247 and 228 set out requirements for Australian listed companies to disclose relevant information on climate risk. While it is significant that such legislative and regulatory reform has occurred, a 2018 report by the Australian Securities and Investment Commission (ASIC) highlights the lack of adherence to the requirements[15]. Indeed, the amount of disclosure has reduced since 2011[16]. Recommendations featured in the ASIC report and others such as the Task Force on Climate-related Financial Disclosures (TCFD) may improve future disclosure by listed companies and highlight the continued focus on improving the quality and extent of climate disclosure.

Another form of legislative reform in Australia is the introduction of the Modern Day Slavery bill in 2018. At the time this report was published the bill was under review in the Senate[17]. The bill will require companies with more than $100 million turnover to disclose risks in their operations and supply chains and the actions the organisation is taking to address such risks. The bill is estimated to cover 3,000 companies in Australia and mirrors other global developments to address the significant and, until recently, little understood issue of modern day slavery.

Regulatory changes are also proposed in Australia with the draft of Edition 4 of the Corporate Governance Principles currently open for public comment. Changes include Principle 3 relating to the disclosure of the core values, culture and anti-bribery policies of listed entities[18], and to Principle 4.4 and 7.4 as described below.

The role of the board in ensuring the integrity of corporate reporting, that's now changed in the draft to ask directors to explain how they have ensured that their corporate reporting portfolios (broader than just their annual report) are accurate, balanced, and understandable, and meets the needs of their investors. It also suggests you may want to use the Integrated Reporting framework to better explain not only how it's accurate but also what you've done to show it meets the needs of your material stakeholders or your shareholders.

Nick Ridehalgh, Partner KPMG

While the above regulatory changes have been criticised for lacking enforcement or penalties for organisations failing to adhere to the changed disclosure requirements, other stakeholders appear to be leading the way in holding organisations to account.

In 2017 a group of shareholders launched a world first legal case by suing the Commonwealth Bank for failing to appropriately disclose the risks to their organisation associated with climate change. The case is based on disclosure in the 2016 directors' report, however, the case also seeks to include disclosure in annual reports[19]. More recently, a 23 year old, concerned about the long term investment security of his superannuation funds, sued the $50 billion REST Super for failing to disclose sufficient information relating to climate change risks within their portfolio. The implications of the outcomes of these two cases cannot be underestimated. Precedents set by such cases would have impacts for corporate reporting across the Australian economy[20].

Dependencies versus impacts

Internationally, emerging reporting initiatives are changing the conversation from the impact an organisation has on society and the environment to an organisation's dependence on these socio-ecological systems.

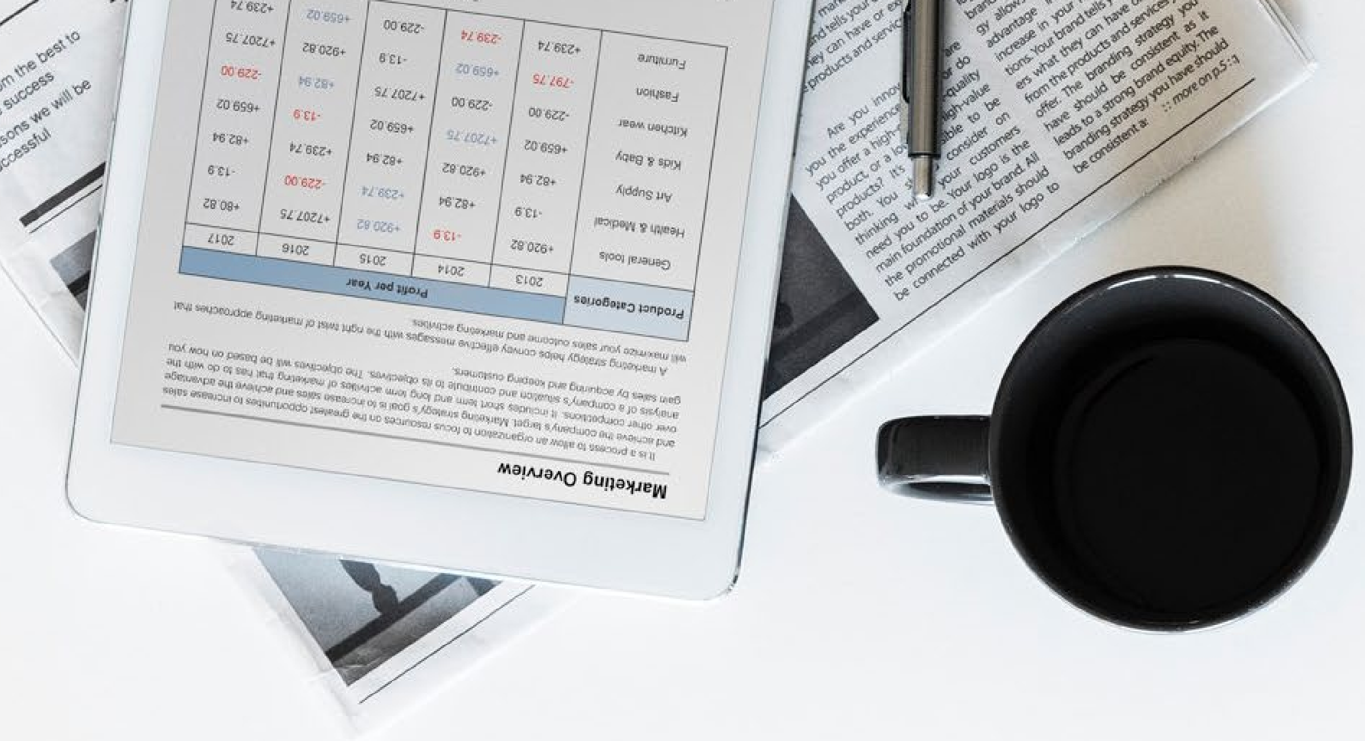
The Natural Capital Coalition's (NCC's) Natural Capital Protocol, the International Integrated Reporting Council (IIRC's) Integrated Reporting Framework, and multi-capital approaches lead organisations to this new and critically important perspective.

I think that shift of perspective from impact to dependence is really the fundamental shift. The valuations we do based on dependency based views are also likely to be more directly applicable for internal decision making than valuations on an impact basis.

Carl Obst, Director IDEEA Group

This change in perspectives also appears to be accompanied by efforts to assess an organisation's position, particularly relating to its ecological sustainability, by a context based or landscape based approach.

The proposed Modern Day Slavery Bill will require companies with more than $100 million turnover to disclose risks in their operations and supply chains and the actions the organisation is taking to address such risks.

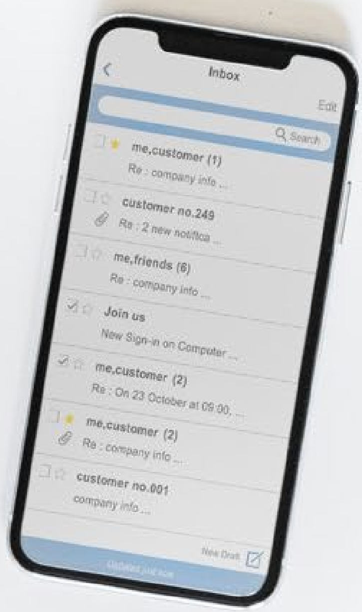


The SEEA allows countries, states and specific locations to more comprehensively record the state of the environment and identify critical information such as carrying capacity of ecosystems.

Supply chain transparency and accountability

The requirement for organisations to disclose information about their supply chain continues to increase.

Indeed, in addition to the Modern Day Slavery legislative reform, supply chain disclosures have also been added to the CDP disclosure requests. This focus is driven in part by prominent events which underscore the significant consequences of organisations failing to adequately manage their often incredibly complex supply chains.



One example focusing attention on supply chains, in addition to understanding the extent of externalities from company operations, was the pioneering work of Puma and Trucost to develop an environmental profit and loss (EP&L) in 2011[21]. Although limited to just three metrics, the EP&L highlighted the failure of reporting to provide a clear picture of the organisation when not considering the supply chain. 85% or EUR 145 million of the impact calculated in the EP&L was associated with impacts in the supply chain which are often not reported by organisations. According to the experts we have interviewed, momentum appears to have waned for the EP&L style of reporting in favour of other reporting frameworks.

The catastrophic event of the Rana Plaza building collapse in 2013 in which 1,134 people died implicated many large MNE such as Primark and Matalan[22].

The complexity of managing global supply chains, particularly in developing countries became evident to the broader public, however, the devastating consequences of failing to do so again placed supply chain management and transparency under the spotlight. This event has led to the development of various initiatives to assist organisations to improve supply chain transparency and to understand and meet the expectations of stakeholders.

While the challenge of providing required data on large, complex supply chains is evident in the above examples, emerging developments such as Blockchain and Big Data offer potential to assist, if not, transform the corporate reporting of supply chains. Trial projects are already underway, such as that run by Cambridge Institute for Sustainability Leadership with a number of major organisations including Sainsbury's and Unilever[23]. The innovative project aims to provide financing benefits to tea farmers in Malawi using a shared data system based on blockchain technology in addition to tracking materials for packaging.

"This technology has the real potential to help banks access more detailed and more reliable information about social and environmental impacts in a secure way, throughout the entire supply chain," said **Marguerite Burghardt**, Head of the Trade Finance Competence Center, BNP Paribas, one of three banking partners involved[24].

Integration of multi-level developments

One final theme which is argued by reporting experts to be highly relevant for the future of corporate reporting is the integration of multi-level developments, particularly between international and national level government reporting and company reporting.

The SDGs are the most high profile of the recent developments in this area, seeking to integrate international policy aims, individual national government efforts and reporting with company level measurement and reporting. This initiative has indeed delivered results in the short time since inception in 2016. Many leading Multi-National Enterprises are already reporting on the contribution of their operations to the SDGs through their corporate reports and incorporating SDG metrics within their data collection.

The SEEA is another reporting initiative which spans international and national level reporting, and which also has the potential for application at corporate level. The leading edge of the SEEA concerns spatially-based ecosystem accounting and a second stage of development of this international standard is currently underway, again led by Australia's Carl Obst, previously of the ABS.

The SEEA allows countries, states and specific locations to more comprehensively record the state of the environment and identify critical information such as carrying capacity of ecosystems. While the current focus is not directed at company reporting and decision making, there are clear implications for companies once national governments hold such valuable information.

Furthermore, efforts to create dialogue between companies and national governments relating to natural capital accounting, the alignment of standards and shared management of ecosystems are also increasing.

I take encouragement from the fact that we have now on the corporate reporting radar these very specific initiatives in the form of science- and context-based greenhouse gas emissions and water targets initiatives.

Dr. Mark McElroy, Executive Director of Center for Sustainable Organizations

Looking to the future for Australian corporate reporting reform - Income inequality and biodiversity loss

Considering the context of global sustainability initiatives globally, this section of the report analyses what we perceive as potential future changes to Australia's corporate reporting efforts, namely, income inequality and biodiversity loss.

As in the United States, **Income inequality** in Australia is a growing concern. Many sectors of Australia's economy have experienced prolonged wage stagnation while executive remuneration continues to grow[25]. Further exacerbating concern over this trend in Australia is the reduced importance of wages as income, with significant increases in income inequality when total wealth is considered Recent research by the Australian Institute for Business & Economics (AIBE) highlights the implications for Australian organisations of continued wage stagnation and income inequality, even for those industries benefiting from stagnant wages[26]. Extensive research across social science, health and more also identify the clear impacts for every income group of a nation which results from income inequality[27].

It is, therefore, a reasonable assumption that Australia may look to address the increasing rate of income inequality through corporate reporting in some form in the future. Australian organisations would benefit from becoming cognizant of this issue and potential implications.

Biodiversity loss represents another major concern within the global sustainability community which has potential for corporate reporting implications including in Australia (terms used interchangeably include biodiversity, ecosystem services and natural capital).

Current regulatory reform has largely focused on the risks to business operations of climate change. However, the role of biodiversity to absorb carbon, and for biodiversity loss to further destabilise planetary and climate systems regionally and globally[28] is a major focus among academics, policy makers, investors and organisations.

Figure 4. Income inequality in Australia[26]

Whether contributing to the loss of species, large-scale deforestation, or unsustainable use of scarce resources, pressure is mounting on organisations to report on biodiversity and natural capital related impacts and dependencies.

Furthermore, the astounding loss of biodiversity upon which society depends is gaining attention. While projections such as the depletion of all commercially viable fisheries by 2050[29] and the collapse of coral reefs globally within the century[30] have been known for some time, recent reports such as the WWF Living Planet Report 2018 highlight the continued and increasing trend of biodiversity loss. Whether contributing to the loss of species, large-scale deforestation, or unsustainable use of scarce resources, pressure is mounting on organisations to report on biodiversity and natural capital related impacts and dependencies.

For example, the CDP (formerly the Carbon Disclosure Project) represents investors and purchasers worth more than US$100 trillion and on their behalf seeks information disclosures from companies based on carbon emissions, water, forests and supply chain[32].

Both water and forest metrics are fundamental to natural capital and each have interdependent relationships with each other and with climate change as featured in the latest Planetary Boundaries framework from the Stockholm Resilience Centre below.

With current rates of biodiversity loss arguably moving Earth into the sixth wave of mass extinction this will continue to be a focal point for sustainability efforts and likely future corporate reporting.

Furthermore, renegotiation of key international policy frameworks including the Convention of Biological Diversity in 2020 will again increase the focus on this topic globally.

What does this all mean for business, society and the planet

The experts we interviewed were asked to outline their views on the implications of the trends in corporate reporting they have been witnessing.

Continued evolution of corporate reporting

Corporate reporting will continue to evolve over time as organisational stakeholders seek non-financial disclosures as a means of addressing ecological and societal challenges. Reporting is also argued to become more dynamic and responsive to emerging disclosure requests. Organisations need to prepare for these reporting changes or face significant financial consequences.

I see the annual report evolving into an integrated report based on the IR framework sitting as an overview of the company with a suite of supporting information primarily on the company website, and special topic focused reports as issues emerge. Organisations will need to improve their understanding of and explanation of the external environment in which they operate and link this back to implications for the organisation.

Nick Ridehalgh, Partner KPMG

As far as implications go for organisations, I think the sooner organisations make Corporate Sustainability reporting a priority the better prepared they will be for the changes that will inevitably come. People talk about it as 'future proofing' and there are real associated risk and reputation reasons for adopting multi-capital reporting ASAP. I think the same applies for economies/governments.

Dr Jane-Gleeson White

Organisations need to be setting out what their strategy is and how they're going to cope with all these changes. You don't change the world in a day, but changes are being made.

Ian Mackintosh, Chair, Corporate Reporting Dialogue

The business community is going to learn bitterly that they have to change. Why? Because the great financial institutions are investing in a responsible manner because of an appreciation that they have to discharge their duty of care to their customers / investors otherwise individuals will have an action for damages against the trustee of their pension fund.

These business persons that are still focused on financial capital and still look at everything through a financial lens and short-term profit at any cost will not be able to raise capital in the next few years. That's what's going to happen.

Professor Mervyn King, Chairman, IIRC

There will be opportunities for government and business to work together as well as greater levels of data available. There's also a potential sovereign risk arising from changed government environmental regulations, so business should start to understand and work within the carrying capacity of the natural resources they rely upon.

Carl Obst, Director IDEEA Group

Systemic Change

While much progress can indeed result from individual changes to corporate reporting through the associated decision making by an organisation's stakeholders, such changes are unlikely to be sufficient from an ecological or societal perspective. Systemic change of the economic system in which organisations operate is seen by many experts as what is ultimately required to move the world economy to a sufficiently sustainable point for the satisfactory continuation of humanity.

I have become aware of how radical and potentially powerful an idea multi-capital reporting is within a corporation, however, I don't think the shift to Corporate Sustainability reporting is going to happen in any substantial, systemic and meaningful way without legislative change. So I still think the concept of the benefit corporation and associated legislative change, a movement now well under way in Australia, is an important component of the new economy.

Dr Jane-Gleeson White

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