SHARE

Shareholder Association for Research and Education

MEMORANDUM

To: John Hughes, Chair, OSC Continuous Disclosure Advisory Committee
Neeti Varma, Accountant, OSC
David Surat, Legal Counsel, Corporate Finance Branch, OSC
From: Gil Yaron, Director Of Law & Policy, Shareholder Association For Research And Education
Date: 6/28/2005
Re: **Corporate Disclosure Of Material Social And Environmental Information**

Complete and timely disclosure of material information is an essential requirement for the fair and efficient operation of capital markets. The presumption underlying the theory of efficient markets is that that the free exchange of ideas in a free market will result in accurate valuations of individual securities. However, it is well recognized that the market is not perfect and that some degree of regulation is required to address market imperfections. This memo considers one such market imperfection – the failure of the market to recognize and report on material social and environmental information with respect to issuer operations.

The Ontario Securities Commission is charged with fostering fair and efficient capital markets and confidence in their integrity. The inability of investors to assess the impact of social and environmental matters on the financial performance of public issuers poses an increasing challenge to this mandate. The costs of social and environmental issues on a company's operations and reputation pose an increasing risk, which is often material in nature.

Both business and the investing public recognize the need for enhanced disclosure in these areas. A poll conducted by the Financial Post and COMPAS in November 2004 found that a majority of Canadian business leaders believe that publicly traded companies should be required to disclose critical extra-financial information that could significantly impact earnings, stock price and shareholder liability: Of the 157 CEOs surveyed:

- 71% said regulators should mandate companies to release information that can affect the bottom line and increase the liability of investors.
- 90% cited the release of information about the safety of products as the most important type of non-financial disclosure.
- 78% said they'd like to see the release of information concerning environmental impact, such as the clean-up costs associated with manufacturing, efficacy and quality of products, pending lawsuits and class-action lawsuits. (30% did not support the release of information involving internal lawsuits, such as sexual harassment and discrimination.)
- 56% desired non-financial disclosure on a continuous or quarterly basis.
- 32% said they'd prefer the information be released on an honour system.
- 70% said management and the audit committee should be held legally responsible for failing to make proper and timely disclosure.
- 22% opposed non-financial disclosure because the additional burdens would be too difficult and costly to implement.

A study entitled *Measures that Matter* conducted by Ernst & Young in 2004 reported that 40% of large American investors' asset allocation decisions are based on intangible information.[1] Investors that want to take advantage of the link between social and environmental indicators and financial performance as criteria for selecting or screening stocks are at a disadvantage because of this information asymmetry.

The views of business and investors are supported by many academic studies which demonstrate a significant and material relationship between corporate social and environmental practices and corporate financial performance in general.[2]

Furthermore, investor protection is predicated on a sustainable economic environment based on long-term sustainable corporate activity. Disclosure practices must be sufficient to protect investors in this manner and ensure long-term investor confidence in the stability of individual corporations, financial markets and the economy in general. From a public policy perspective, risks and costs not valued in financial statements are not accounted for by companies and often borne by the public purse.

Provincial governments have failed to keep step with regulatory developments in this area. Many developed economies – including the United States and Britain – have introduced specific regulations and guidance with respect to disclosure of social and environmental information. In contrast, Canadian issuers have virtually no statutory guidance on what information must be disclosed aside from general materiality standards. Interestingly, governments and regulators have readily enacted mandatory disclosure requirements with respect to specific corporate governance practices – another class of extra-financial information – without the skepticism regarding the materiality of such information or concerns about how to measure, value and report on it.

Furthermore, securities administrators have not focused attention on social and environmental disclosures as part of their systematic continuous disclosure reviews and enforcement practices. Studies conducted by the Securities Exchange Commission and the Government Accountability Office in the United States demonstrate that issuers have not complied with environmental disclosure requirements in that country, in part due to a lack of enforcement by the SEC itself.[3]

This memo provides contextual information for a discussion of corporate SEE disclosure by the CDAC at its upcoming meeting in May 2005. The memo addresses ten issues that commonly arise in relation to the issue of non-financial disclosures:

1. What is the policy rationale for disclosure of social and environmental information?
2. What is the current standard for disclosure by public issuers in Canada and other jurisdictions with respect to social and environmental information?
3. To what extent is social and environmental information material in nature?
4. To what extent are Canadian issuers disclosing material social and environmental information?

---

[1] Ernst & Young, *Measures that Matter* (2004) available at www.corporatesunshine.org/measuresthatmatter.pdf.

[2] A list of studies can be provided on request. See e.g. Marc Orlitzky, Frank L. Schmidt, Sara L. Rynes, "Corporate Social and Financial Performance: A Meta Analysis" (Social Investment Forum Foundation, December 2004) available at www.socialinvest.org/areas/research/Moskowitz/2004MoskowitSummary.pdf.

[3] Government Accountability Office, *Environmental Disclosure: SEC Should Explore Ways to Improve Tracking and Transparency of Information* (Washington D.C.: GAO, July 2004)(GAO-04-808); US S.E.C., *Summary by the Division of Corporation Finance of Significant Issues Addressed in the Review of the Periodic Reports of the Fortune 500 Companies* (posted on SEC website 27February 2003) available at www.sec.gov/divisions/corpfin/fortune500rep.htm.

5. Should social and environmental reporting be mandatory or voluntary?
6. Where should social and environmental information be reported?
7. How are issuers supposed to value social and environmental events?
8. What processes exist for independent verification of social and environmental disclosures?
9. What will be the effect for issuers?
10. Would not better enforcement of existing disclosure requirements be sufficient?

The memo concludes with a series of recommendations for consideration by the OSC and the CSA.

1. What is the policy rationale for disclosure of social and environmental information?

The overriding purpose of securities regulation is to facilitate the efficient functioning of capital markets by enabling market participants to take in to account all material information – including social and environmental information -- when valuing companies. In addition, there are several public policy reasons for desiring complete and continuous disclosure of social and environmental information:

- Disclosure of social and environmental legal proceedings and violations, and the accompanying public scrutiny, provides a specific and general deterrent to future corporate noncompliance.
- Disclosure of social and environmental liabilities provides corporations an incentive to address the liabilities expeditiously. It may also spur the development of innovative and lower cost approaches to addressing the concern.
- Disclosure of social and environmental performance information helps level the playing field for companies that are good performers in those respects.
- Disclosure of social and environmental performance information in periodic statements -- such as the MD&A -- filed on SEDAR raises the level of awareness of environmental issues in corporate management.

2. What is the current standard for disclosure by public issuers in Canada and other jurisdictions with respect to social and environmental information?

Canada

Canadian issuers are required to disclose all information that constitutes a "material fact" or a "material change". Most Canadian jurisdictions in Canada, including Ontario, currently apply a "market impact" test to determine materiality. Information is deemed material if it would reasonably be expected to have a significant effect on the market price or value of such securities. The Ontario Securities Commission's Five Year Review Committee Final Report recently recommended adoption of the "reasonable investor" test and draft legislative provisions have been agreed to among the CSA and published by the CSA for public comment as part of USL.[4] Currently, the United States and Quebec apply the "reasonable investor" test for determining materiality. Specifically, whether there is a substantial likelihood that a fact "would have been viewed by the

[4] *See Five Year Review Committee Final Report: Reviewing the Securities Act (Ontario) – Status of Recommendations* (August 18, 2004) at www.osc.gov.on.ca/Regulation/FiveYearReview/fyr_20040818_fairness_status-rpt.pdf.

reasonable investor as having significantly altered the "total mix" of information made available."[5] The "reasonable investor" test has been adopted by the CICA in its *Guidance on Preparation and Disclosure: Management Discussion & Analysis*.[6]

National Policy 51-201 ("Disclosure Standards") provides that "in making materiality judgements, it is necessary to take into account a number of factors that cannot be captured in a simple bright-line standard or test. These include the nature of the information itself, the volatility of the company's securities and prevailing market conditions. The materiality of a particular event or piece of information may vary between companies according to their size, the nature of their operations and many other factors. An event that is "significant" or "major" for a smaller company may not be material to a larger company. Companies should avoid taking an overly technical approach to determining materiality."[7]

NP51-102 also identifies the following as examples of information that may be material: "any development that affects the company's resources, technology, products or markets", "major labour disputes or disputes with major contractors or suppliers", "the commencement of, or developments in, material legal proceedings or regulatory matters."[8]

With respect to external political, economic or social developments, the NP51-102 provides:

> "Companies are not generally required to interpret the impact of external political, economic and social developments on their affairs. However, if an external development will have or has had a direct effect on the business and affairs of a company that is both material and uncharacteristic of the effect generally experienced by other companies engaged in the same business or industry, the company is urged to explain, where practical, the particular impact on them. For example, a change in government policy that affects most companies in a particular industry does not require an announcement, but if it affects only one or a few companies in a material way, such companies should make an announcement."[9]

Prospectus

With respect to environmental disclosures, under Ontario securities regulation, the prospectus must include a narrative description of the business of the issuer, including "…the financial and operational effects of environmental protection requirements on the capital expenditures, earnings and competitive position of the issuer in the current financial year and the expected effect, on future years."[10] The issuer must also list "risk factors material to the issuer that a reasonable investor would consider relevant to an investment in the securities being distributed," such as "environmental and health risks."[11]

---

[5] *TSC Industries, Inc. v. Northway Inc.,* [1976] 426 U.S. 428, 449.

[6] Canadian Institute of Chartered Accountants, Management's Discussion and Analysis: Guidance on Preparation and Disclosure (CICA: November 2002) at para. 230.3: "Information is material if it would be considered important by an investor, acting reasonably, in making a decision to invest or continue to invest in the company."

[7] National Policy 51-201 (Disclosure Standards) (2002) 25 OSCB 4492 (12 July 2002), s.4.2(1).

[8] NP51-201, s.4.3.

[9] NP51-201, s.4.4. *See also* CDNX timely disclosure policy, s.2.4 and TSX Venture Exchange timely disclosure policy, s.2.3. *But see* discussion under "SEC Commentary" infra.

[10] Form 41-501F (General Prospectus Requirements), s.4(h). *See also* s.6.3(1)(d), 6.3(10)(c) with respect to mineral projects.

[11] *Ibid.*, s.20.1(1).

Management Discussion and Analysis

The MD&A requires disclosure of expenses that are unusual or infrequent events or transactions or otherwise represent any significant economic change materially affecting income from operations, along with the extent to which the income from operations are affected.[12] Risks or uncertainties necessary for an understanding of the issuer's financial condition, changes therein, or results of operations, should also be disclosed.[13] It is important to note that while these requirements include consideration of unusual or infrequent social and environmental events, as well as social and environmental risks and uncertainties, there is no guidance provided to issuers to direct them to consider such potentially material considerations. Issuers are also required to disclose details regarding significant projects that have not started generating operating revenues, which explicitly include land use or political or environmental issues.[14]

In January 2002, the Canadian Institute of Chartered Accountants released guidance on the disclosure requirements in an issuer's Management Discussion & Analysis. The guidance advises issuers that they should disclose information regarding key performance drivers associated with social and environmental responsibilities (see Appendix A for relevant provisions). The CICA's MD&A Guidance suggests social and environmental costs should be considered in the aggregate and with a long-term perspective.[15] The CICA issued a draft interpretative release for comment on the MD&A Guidance in March 2005.[16]

As the CICA's MD&A Guidance states "research tells a consistent and compelling story that improved disclosure leads to a lower cost of capital, a more appropriate risk premium and better capital allocation decisions. In today's global market place, it is critical that sufficient reliable, relevant and useful information be disclosed to permit proper valuation of companies."[17]

Annual Information Form (AIF)

The Annual Information Form (AIF) also sets out a number of items that require discussion by issuers, including:

- "…the financial or operational effect of environmental protection requirements on the capital expenditures, earnings and competitive position of the Issuer for the current fiscal year and any expected impact on future years."[18]

---

[12] Form 51-109F1, s.1.4(j) ((2004) 27 OSCB 3499).

[13] *Ibid*., s.1.4(g).

[14] *Ibid*., s.1.4(d).

[15] According to the SEC, several omissions or misstatements not individually material may be material in the aggregate: *Gould v. American Hawaiian Steamship Company*, 331 F. Supp. 981, 997 (D. Del. 1971).

[16] CICA, *Interpretative Release: Disclosing the Financial Impact of Climate Change and other Environmental Issues* (draft)(CICA, March 2005) available at www.cica.ca/multimedia/Download_Library/Research_Guidance/MDandA_Business_Reporting/English/IR_2_draft.pdf.

[17] CICA, *supra* note 6 at para. 120.1.

[18] Form 51-102F2, s.5.1(1)(a)(k) ((2004) 27 OSCB 3512).

- a description of and steps taken to implement social or environmental policies that are fundament to an issuer's operations, such as policies regarding the company's relationship with the environment or with the communities in which it does business, or human rights policies[19]; and
- Risk factors, including environmental and health risks, regulatory constraints, economic or political conditions that would be likely to influence investor decision-making.[20]

While the requirement to identify and discuss social and environmental policies is important, other jurisdictions impose an additional requirement that companies indicate where they have not implemented such policies.

As the CICA's draft Interpretative Release suggests, issuers and regulators should give consideration to providing AIF disclosures in the MD&A.

Multilateral Instrument 52-109

New certification requirements pursuant to Multilateral Instrument 52-109 also have the potential of ensuring consideration of social and environmentally material information by an issuer its financial statements, MD&A, AIF and information circular.

MI52-109 requires CEOs and CFOs to certify that they have designed disclosure controls and procedures (or caused them to be designed under their supervision) to provide reasonable assurance that (i) material information relating to the issuer and its consolidated subsidiaries that has to be included in filings with securities regulators is recorded, processed, summarized and reported within the specified time periods, and (ii) that such information is made known to the CEO and CFO in order for timely decisions to be made about its disclosure. The CEO and CFO will also be required to certify that they have evaluated the effectiveness of the disclosure controls and procedures as of the end of the period covered by the annual filings, and that they have disclosed their conclusions of that evaluation in the annual MD&A. Disclosure controls and procedures indicates that they cover all information required to be disclosed in the interim and annual filings as well as other continuous disclosure filings such as information circulars.

In addition, MI 52-109 requires CEOs and CFOs to acknowledge their responsibility for establishing and maintaining internal control over their companies' financial reporting. Internal control over financial reporting is defined as the process designed to provide reasonable assurance about the reliability of financial reporting and the preparation of financial statements in accordance with GAAP. The CEO and CFO is required to certify that they have designed such internal control over financial reporting, and have caused to be disclosed in the MD&A any material changes in internal control during the most recent interim period.

CICA Handbook

Securities rules mandate that financial statements be prepared in accordance with GAAP. The Canadian Institute of Chartered Accountants' Handbook provides guidance on the interpretation of GAAP, including the proper treatment of environmental liabilities. Section 3060 of the Handbook requires that an accrual for the future removal and site restoration costs be made through charges to income. These future environmental liabilities are to be reported only "when the likelihood of their incidence is established as a result of environmental law, contract, or because the enterprise has established a policy to restore the site."

---

[19] *Ibid.,* item5.1(4).

[20] *Ibid,* item 5.2.

Future expenditures are to be recognized in financial statements if the transaction or event has already occurred. Past environmental damage is a triggering event when there is environmental legislation that requires a company to undertake remediation.

Public issuers contend that social and environmental information of a material nature is already captured under the existing disclosure standards cited above. However, disclosure practices of public issuers to date suggest otherwise. Issuers in their reporting have traditionally overlooked social and environmental information pertaining to their operations. Furthermore, guidance has not been provided and existing standards rarely monitored or enforced. The result is the ability of issuers to ignore such information and not disclose it unless the financial implications are direct and extremely obvious.[21]

United States

SEC Regulation S-K

The United States Securities Exchange Commission (SEC) Regulation S-K sets out specific reporting thresholds for environmental liabilities by listed companies.

SEC Regulation S-K, Item 101 (Description of Company's Business) requires a company to identify any material effects that compliance with existing or anticipated environmental laws and regulations may have upon the capital expenditures, earnings and competitive position of the company and its subsidiaries.

Item 103 of SEC Regulation S-K requires disclosure of an administrative or judicial proceeding related to compliance with federal, state or local environmental laws where the proceeding is:

a) material to the issuer's business or financial condition,
b) involves penalties and associated charges exceeding 10 percent of the current assets of the issuer and its subsidiaries on a consolidated basis, or
c) involves a governmental authority as a party and potential monetary sanctions exceeding $100,000.[22]

Companies are instructed to apply the standard for materiality separately to each proceeding or set of proceedings presenting "in large degree the same legal and factual issues as other proceedings pending or known to be contemplated".

Item 303 also requires that management disclose environmental contingencies in the issuer's MD&A that may reasonably have a material impact on net sales, revenue, or income from continuing operations.[23] This includes a discussion of business trends or events likely to have a material effect on the company's financial condition. Environmental issues such as greenhouse gas emission reduction requirements, proposed hazardous substance restrictions or other regulatory constraints could qualify as "trends or events" that should be included in financial reports.

---

[21] A recent study by the Rose Foundation for Communities and the Environment documents numerous strategies employed by issuers to avoid or delay assessment of environmental liabilities: Sandford Lewis & Tim Little, *Fooling Investors & Fooling Themselves: How Aggressive Corporate Accounting & Asset Management Tactics Can Lead to Environmental Accounting Fraud* (Oakland, CA: Rose Foundation, July 2004).

[22] Regulation S-K, Item 103.

[23] Regulation S-K, Item 303.

The same disclosure of environmental legal proceedings is required by Item 103, Instructions 1-4 of the SEC's Regulation S-B (17 CFR 228.103), applicable to those businesses using the SEC's small business issuer reporting system.

SAB 99

Although the SEC provides quantitative materiality thresholds for environmental reporting, in 1999 the Commission clarified that "excessive reliance on certain quantitative benchmarks…is inappropriate." SEC Staff Accounting Bulletin 99 clarifies that quantitative information can be material, and "misstatements are not material simply because they fall beneath a quantitative threshold." This interpretation helps pave the way for better disclosure of certain social and environmental issues and intangible assets.

SEC Staff Accounting Bulletin 92 ("SAB 92")

SEC Staff Accounting Bulletin 92 ("SAB 92") provides guidance on accounting and disclosure obligations for contingent environmental liabilities and interprets FAS 5. SAB 92 provides that the minimum loss estimate in a range can be used for accrual purposes if no amount within a range is a better estimate than any other amount within the range.

In addition, the American Institute of Certified Public Accountants Statement of Position 96-1 ("SOP 96-1") provides guidance for recognizing, quantifying, and disclosing environmental liabilities, including benchmarks for making materiality determinations at various stages of assessment and remediation.

FASB Statement 143

FASB Statement 143 (Accounting for Retirement Asset Obligations) addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs resulting from the acquisition, construction, development and (or) the normal operation of a long-lived asset, except for certain obligations of lessees. The Statement requires an entity to recognize and value known, foreseeable environmental liabilities of a material nature even when the environmental liability is based on a future event. FASB Interpretation 47 provides several examples of such obligations including costs of renovating a factory containing asbestos, disposal of contaminated bricks used in a smeltering kiln, and disposal of chemically treated wood poles by a telecommunications company.

Statement of Financial Accounting Standards No. 5 ("FAS 5")

Statement of Financial Accounting Standards No. 5 ("FAS 5") addresses accounting and reporting of loss contingencies such as projected costs for site clean-up or remediation.[24] Under FAS 5, loss contingencies must be accrued only if (i) it is "probable" that an asset has been impaired or that a liability has been incurred, and (ii) the amount of the loss can be "reasonably estimated."

---

24 This Statement establishes standards of financial accounting and reporting for loss contingencies. It requires accrual by a charge to income (and disclosure) for an estimated loss from a loss contingency if two conditions are met: (a) information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements, and (b) the amount of loss can be reasonably estimated. Accruals for general or unspecified business risks ("reserves for general contingencies") are no longer permitted. Full text available at http://www.fasb.org/pdf/fas5.pdf.

Sarbanes-Oxley

The Sarbanes-Oxley Act of 2002 established a system of increased responsibility and accountability for public company financial disclosures, which could affect the way that social and environmental information is collected, evaluated and reported. Of particular relevance for environmental reporting, the Section 404 requirement that a publicly held company have in place an "internal control program" to assure the accuracy of its financial reporting and disclosure. Section 302(a) requires that the CEO and CFO certify under Section 302(a) to the effectiveness of the controls, and that the financial statements fairly represent in all material respects the financial situation of the company with no material omissions.

In designing its internal control program, a company may be able to build on programs already in place. For example, many companies already use environmental auditing or similar compliance assurance programs, which can be used to identify current and anticipated environmental compliance costs and liabilities that must be evaluated for SEC reporting. More and more companies are now using environmental management systems, including self-assessments and management review, to track and improve environmental performance. Increasingly, companies design information flow systems to include the type of environmental information that will need to be disclosed to auditors
and, potentially, to the SEC.

A number of companies developed or modified their information gathering systems in response to the 1996 *Caremark* decision[25], which held that corporations owe their shareholders a duty to put programs in place to ensure timely flow of information concerning operations, risks, potential liabilities and matters of similar import to the business managers and directors so as to enable responsible business decisions to be made. Even before *Caremark*, a number of companies had internal "compliance certification" programs under which plant managers would certify to the next tier of management that all of the facilities and activities under their jurisdiction were in compliance with all applicable laws, except as specifically disclosed. These certifications then would be made up the line by the regional managers, ultimately to the CEO. This type of program is often supported by the legal department to help maintain a high level of compliance and can be a key component in the development and evaluation of environmental information for SEC reporting.

Although the full implications of Sarbanes-Oxley on environmental reporting have yet to be realized, companies must be able to demonstrate they have established reliable, validated protocols for identifying, tracking, analyzing, and judging the potential materiality of existing and contingent environmental liabilities, and that they have adhered to the letter and the spirit of Sarbanes-Oxley in their financial disclosures.

SEC Commentary

SEC's Acting Chairman, Laura Unger, stated in a letter to Congressman Frank Wolf: "The fact that a foreign company is doing material business with a country, government, or entity on [U.S. Treasury Department's Office of Foreign Assets Control's] sanctions list is, in the SEC staff's view, substantially likely to be significant to a reasonable investor's decision about whether to invest in that company. Therefore, in accordance with existing disclosure rules and the SEC's investor protection mandate, the staff of the Division of Corporation Finance will seek information from registrants about material business in, or with, countries, governments, or entities with which U.S. companies would be prohibited from doing business under economic sanctions administered by OFAC. Our aim is to make available to investors additional information

---

[25] *In Re Caremark International, Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch.1996).

about situations in which the material proceeds of an offering could - however indirectly - benefit countries, governments, or entities that, as a matter of U.S. foreign policy, are off-limits to U.S. companies."[26]

An accompanying memo from the SEC Office of Corporation Finance refers to "consumer boycotts", "business risks imposed by political instability", "the imposition of economic sanctions", "lawsuits claiming environmental, personal, or other damage caused by the way a company performed its operations in a particular country", and public opposition to the company arising from its operations in a country facing U.S. governmental sanctions as all potentially material information.[27]

ASTM Standards on Environmental Cost Estimation and Liabilities Disclosure

Although not yet formally adopted by the main US accounting standards setters, the American Society for Testing and Materials developed two environmental accounting standards. ASTM E-2137, *Estimating Monetary Costs and Liabilities for Environmental Matters*, outlines a hierarchy of preferred cost estimation techniques, ranging from "Expected Value" (which employs weighted probability analysis) as the highest, to "Known Minimum Value" as the least. ASTM 2173, *Disclosure of Environmental Liabilities*, explicitly instructs issuers to aggregate similar environmental liabilities before applying a materiality test.

United Kingdom

On March 16, 2005, the British government adopted new regulations to the *Companies Act 1985* that will require UK 1290 British-based companies listed on the London, New York and Nasdaq stock exchanges to produce Operating and Financial Reviews (OFRs) -- similar to the MD&A – as well as a Directors' Report for all shareholders for financial years beginning on or after 1 April 2005 or face unlimited fines. According to the Regulation, the OFR must provide a balanced and comprehensive analysis, consistent with the size and complexity of the business. It must address main trends and factors underlying and that are likely to affect the development, performance and position of the business of the company during the financial year. In addition, "a description of the principal risks and uncertainties facing the company," which includes information about environmental matters (including the impact of the business of the company on the environment), information about the company's employees, and information about social and community issues.[28]

The report must also "to the extent necessary for an understanding of the development, performance or position of the business of the company, include…where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters." Key performance indicators are defined as "factors by reference to which the development, performance or position of the business of the company can be measured effectively." Information about policies governing these aspects of a company's operations must be included as well as the extent to which such policies have been successfully implemented. The British framework also includes unique governance requirements. Directors must have "expertise and competence" in stakeholder issues and must consult with stakeholders as part of preparing the OFR to determine whether current issues may be material and thus subject to disclosure. Where the OFR does not provide such information, it must indicate which kinds of information and analysis is not provided. Similar reporting requirements are specified for the Directors' Report.

---

[26] Correspondence from Acting Chairman Laura S. Unger to the Honorable Frank P. Wolf (May 8, 2001).

[27] Memorandum from David B.H. Martin (Director, Division of Corporation Finance) to Acting SEC Chairman, Laura Unger (8 May 2001).

[28] *The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005*, Schedule 7ZA, ss.2-6.

The OFR falls under the purview of the UK Accounting Standards Board which published draft standards for OFR reporting in 2004. The draft standards recognize that the determination of what information is material is the responsibility of the directors. However, it provides that "investors' needs are paramount when directors consider what information shall be contained in the OFR. Information in the OFR will also be of interest to users other than investors, for example customers, suppliers, employees and society more widely. The directors will need to consider the extent to which they will report on issues relevant to those other users where, because of their influence on the performance of business and its value, they are also of significance to investors."[29]

Financial Reporting Standard (FRS 12) requires publicly listed companies to provide for liabilities or obligations arising from past events that are of an uncertain timing or amount, such as contaminated land where there might be an obligation to provide clean-up costs and other economic capital to settle pending claims.[30]

Internal Control, Guidance for Directors on the Combined Code (Turnbull Report) was issued by the Institute of Chartered Accountants in England and Wales in 1999 and requires all listed companies to disclose how they are managing significant business risks including environmental and reputation issues.[31] In July 2004 the Financial Reporting Council (FRC) announced a review of the Turnbull Guidance.

Other Jurisdictions

Since 2001, France's Assemblée Nationale has mandated social and environmental disclosure as part of its Nouvelles Régulations Économiques (NRE). Article 116 of the NRE requires all French corporations listed on the premier marché to annually report on the social and environmental impact of their activities commencing with their 2003 annual reports.[32] The Assemblée Nationale subsequently implemented Article 116 through the issuance of Decree Number 2002-221 (Decree) on February 20, 2002. The Decree establishes nine separate categories of social information that must appear in the annual reports of listed French corporations.[33] Similarly, the Decree establishes nine categories of information for disclosure with respect to the environmental consequences of corporate activities.[34]

Australian disclosure rules also mandate qualitative environmental & social reporting. Section 299 of Australia's *Corporations Act 2001* requires all 1200 companies listed on the Australian Stock Exchange to prepare an annual directors' report that includes details about compliance with environmental regulations. This requirement reiterates an earlier environmental disclosure requirement enumerated, but poorly implemented, in Australia's *Company Law Review Act of 1998*. Reporting is triggered by environmental performance rather than financial materiality, such as significant contingent liabilities and capital commitments.

---

[29] Accounting Standards Board, *Reporting Standard 1: Operating and Financial Review (Exposure Draft)*, principle 8 available at http://www.asb.org.uk/images/uploaded/documents/OFREDweb.pdf.

[30] A copy of FRS 12 is available at www.asb.org.uk/images/uploaded/documents/FRS%2012.pdf.

[31] A copy of the Turnbull Report is available at www.icaew.co.uk/viewer/index.cfm?AUB=TB2I_6342&tb5=1&CFID=3570958&CFTOKEN=77680195.

[32] *See* Law No. 2001-420 of May 15, 2001, J.O., May 16, 2001, art. 116, p. 7776.

[33] *See* Decree No. 2002-221 of Feb. 20, 2002, J.O., Feb. 21, 2002, p. 3360, art. 148-2.

[34] *See* ibid. art. 148-3.

Denmark adopted legislated public environmental reporting requirements in 1996 mandating approximately 3000 companies to publish environmental reports. Norway has legislated the inclusion of environmental information in corporate annual financial reports. Finally, in 2003, the Johannesburg Securities Exchange began requiring listed companies to comply with the second King Report on Corporate Governance, which demands SEE disclosure per the Global Reporting Initiative framework. This particularly requires listed companies to report on the nature and extent of the strategies to address the potential impact of HIV/ AIDS on their activities.

3. To what extent is social and environmental information material in nature?

Demonstrating the significance of specific social and environmental events on the financial performance of a company has been a long-standing preoccupation for investors. The difficultly with the findings of most studies is that they consider aggregate correlations between social and environmental performance and financial performance, which is of limited value in assessing the materiality of specific events with respect to individual companies. Nevertheless, such findings do demonstrate that social and environmental factors may have a material effect on financial performance and therefore should be considered and assessed as part of a company's financial audit.[35]

In 2004, the United Nations Environment Programme (UNEP) released a seminal study entitled *The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing*. The study involved eleven reports from nine brokerage houses analyzing the materiality of environmental, social and corporate governance considerations and criteria on financial performance in seven industry sectors. The study found agreement from all reports that these issues affected long-term shareholder value, sometimes profoundly. More importantly for our purposes, the brokerage firms indicated that "financial research was greatly aided by clear government positions with respect to environmental, social and corporate governance issues."[36] The study also concluded by urging governments to "recognize that in general, current definitions of… financial materiality and corporate disclosure requirements do not incorporate or ensure the integration of environmental, social and corporate governance issues into fundamental company analysis."[37] It also urged regulators to update their regulations regarding financial materiality and financial disclosure to mandate and standardize the inclusion of material environmental, social and corporate governance criteria in disclosure frameworks. This speaks to the need for regulations that provide clear, measurable and comparative standards so that market participants make accurately assess and compare the environmental, social and corporate governance risks of a company.

A literature review of 60 recent empirical studies conducted by the UK Environment Agency in September 2004 found that 85% of the total number of studies assessed demonstrated a positive correlation between environmental governance and/or events and financial performance.[38] The study also considered case studies of 15 individual companies from different sectors and found that many demonstrated a link between environmental governance and financial performance.

---

[35] A full list of more than 100 academic and industry studies is available from the author on request.

[36] UNEP Finance Initiative, *The Materiality of Social Environmental and Corporate Governance Issues to Equity Pricing* (Switzerland: UNEP, June 2004) at p. 5 available at www.unepfi.org/work_programme/investment/materiality/.

[37] *Ibid.*

[38] Andrew White & Matthew Kiernan, *Corporate Environmental Governance* (Bristol, UK: Environment Agency, September 2004) available at www.environment-agency.gov.uk/commondata/acrobat/fi045webdoc_920701.pdf.

A similar study conducted by the US Environmental Protection Agency found a "moderate positive correlation exists between environmental and financial performance, [and that] causation has yet to be determined."[39]

Several recent academic meta-studies have concluded that a significant and positive relationship exists between corporate social and environmental performance and corporate financial performance.[40]

A recent study by the World Resources Institute that reviewed the impact of known, impending environmental issues on capital expenditures and future earnings of 13 publicly-traded corporations in the pulp and paper industry found a wide variation in impact. Expected financial impacts ranged from no impact, to over 10 percent of shareholder equity.[41]

Another study reviewed the disclosures of 35 American food companies about genetically engineered crops. It found that only two companies – Kraft Foods and Interstate Bakers – mentioned genetically engineered food as a potential liability in their annual reports to shareholders. No company elaborated on measures being taken to mitigate harm, avoid future liabilities, and address future profitability. The materiality of information with respect to GMOs is demonstrated in the example of the recall of Kraft-manufactured Taco Bell taco shells contaminated with StarLink corn by the Food and Drug Administration at an estimated cost of $10 million in lost revenue to the company.[42]

4. To what extent are Canadian issuers disclosing material social and environmental information?

Research to date has shown that issuers are consistently underreporting when it comes to social and environmental information. A recent review of disclosure practices by issuers in three industry sectors – oil and gas, mining, financial services – by Stratos Inc. for the Capital Markets and Sustainability Program of the National Roundtable on the Economy and the Environment found that social and environmental disclosures by Canadian issuers were consistently deficient.[43]

A study of ten hard rock mining companies listed on U.S. and Canadian stock exchanges found reporting of information with respect to ten financially material environmental events – including dam failures, increases in remediation liabilities and increased bonding requirements – was deficient in all but one instance, especially

---

[39] Environmental Capital Markets Committee, US E.P.A., *Green Dividends?: The Relationship between Firms' Environmental Performance and Financial Performance*, (U.S. EPA, May 2000).

[40] *See e.g.* Marc Orlitzky, Frank L. Schmidt, Sara L. Rynes, "Corporate Social and Financial Performance: A Meta Analysis" (Social Investment Forum Foundation, December 2004) available at http://www.socialinvest.org/areas/research/Moskowitz/2004MoskowitSummary.pdf.

[41] A recent study that reviewed the impact of known, impending environmental issues on capital expenditures and future earnings of 13 publicly-traded corporations in the pulp and paper industry found a wide variation in impact. Expected financial impacts ranged from no impact, to over 10 percent of shareholder equity: Robert Repetto and Duncan Austin, *Coming Clean: Corporate Disclosure of Financially Significant Environmental Risks* (Washington D.C.: World Resources Institute, 2000) available at http://pubs.wri.org/pubs_description.cfm?PubID=3040.

[42] U.S. PIRG Education Fund, *Duty to Disclose: The Failure of Food Companies to Disclose risks of Genetically Engineered Crops to Shareholders* (2004) available at http://uspirg.org/uspirg.asp?id2=14069&id3=USPIRG&.

[43] Stratos, Corporate Disclosure and Capital Markets: Demand and Supply of Financially Relevant Corporate Responsibility Information (Ottawa: Stratos, December 22, 2004)(draft). Final version to be available at http://www.nrtee-trnee.ca/eng/programs/Current_Programs/Capital-Markets/Capital-Markets_E.htm.

with respect to MD&A reporting.[44] Canadian mines and mining companies in the study included the Anvil Range Mining Corporation and the Faro Mine, Cambior Inc. and the Omai Mine in Guyana, Royal Oak Mining Ltd. and the Giant Mine in the Northwest Territories, Boliden Ltd. and the Los Frailes Mine in Spain, Dakota Mining Company and the Gilt Edge Mine in South Dakota, and Teck Cominco and the Red Dog Mine in Alaska.

The balance of studies evaluating disclosure practices consider American companies. Given that disclosure standards are more prescriptive in the US, it can be assumed for our purposes that the studies' findings provide a conservative assessment of corporate disclosure practice in Canada.

An SEC review of all annual reports on Form 10-K by Fortune 500 companies in 2002, with particular focus on oil and gas, mining and manufacturing companies, found that many did not provide adequate disclosure relating to environmental and product liabilities. The review also determined that companies could improve their disclosures required by SAB92. The SEC urged companies with material contingent liabilities to carefully review their disclosures and ensure that they include all required information. It also urged companies to provide meaningful analysis in their MD&A as to why the amounts charged in each period were recorded and how the amounts were determined.[45]

Previously, a 1992 Price Waterhouse survey of SEC registrants found that 62 percent of respondents had not accrued known environment-related exposures on their financial statements.[46] A 1996 study of environmental disclosure by companies involved in initial public offerings, who were known to be potentially responsible parties at one or more Superfund sites, found a non-reporting rate of 54 percent as compared to a non-reporting rate of 61 percent for currently registered companies.[47] And a 1998 study by the U.S. Environmental Protection Agency's Office of Enforcement and Compliance Assurance found 74% of companies still failed to report in their 10-Ks as required by Regulation S-K cases where environmentally related legal proceedings could result in governmental monetary sanctions of more than $100,000.[48] An earlier U.S. General Accounting Office study of disclosure of Superfund toxic cleanup liabilities by the top 16 publicly held property and casualty insurance companies found only two companies disclosed dollar amounts for environmental claims in their 1990 annual reports and three in 1991. However, five in 1990 and eight in

---

[44] Robert Repetto, *Silence is Golden, Leaden, and Copper* (Yale School of Forestry & Environmental Studies, July 2004) available at http://www.yale.edu/environment/downloads/repetto_report_full.pdf.

[45] US S.E.C., *Summary by the Division of Corporation Finance of Significant Issues Addressed in the Review of the Periodic Reports of the Fortune 500 Companies*, supra note 2.

[46] Environmental Services Group, Price Waterhouse. (1992). Accounting for Environmental Compliance: Crossroads of GAAP, Engineering and Government – Second Survey of Corporate America's Accounting for Environmental Costs. Pittsburgh, PA: Price Waterhouse.

[47] Freedman, Martin and A.J. Stagliano. (1996). *Environmental Disclosure of Companies Involved in Initial Public Offerings*. Available at http://panopticon.csustan.edu/cpa96/papers.htm/freedman.htm.

[48] Office of Enforcement and Compliance Assurance, U.S. Environmental Protection Agency, Guidance on Distributing the Notice of SEC Registrants' Duty to Disclose Environmental Legal Proceedings in EPA Enforcement Actions (Washington D.C.: EPA, 1998) cited in Susannah Blake Goodman, Jonas Kron, and Tim Little, *The Environmental Fiduciary: The Case for Incorporating Environmental Factors into Investment Management Policies* (Oakland, California: Rose Foundation, 2002) at 14-16.

1991 indicated involvement in potentially costly litigation over environmental claims.[49] Recent studies indicate that non-mandated disclosure levels by US issuers are even poorer."[50]

A study entitled *The Gap in GAAP* by the Rose Foundation in December 2003 found that deficiencies in reporting of material environmental liabilities as required by regulation were due to loopholes in Generally Accepted Accounting Principles. The report concluded "the Securities and Exchange Commission could close significant gaps in corporate environmental disclosures by drawing from two new standards recently released by the American Society for Testing and Materials. These standards call for a robust **expected value probability analysis** to education disclosure decisions and require **aggregation of environmental liabilities** before determining materiality."[51]

Disclosures respecting financial risks associated with climate change by American companies in five major industry sectors reportedly improved in the three years from 2002 to 2004, however extreme variations remain. According to the Friends of the Earth's *Third Survey of Climate Change Disclosure in SEC Filings of Automobile, Insurance, Oil & Gas, Petrochemical, and Utilities Companies*, the overall rate of climate reporting was 39% in 2004.[52] Disclosure by some companies in each sector suggests that climate change is a material business risk in each of the industry sectors surveyed and points to the subjectiveness in assessing materiality. Another study by the U.S. Government Accountability Office also found wide variations in disclosures, but found it not possible to determine whether this was a consequence of differences in risk exposure across companies and sectors or differences in the extent to which companies are disclosing these risks.[53]

The findings from such studies are confounded by the existence of what Alan Willis and Julie Desjardins refer to as a "communications gap" between reporting issuers and investors. A gap exists "where (a) companies have failed to perceive the strategic business value in articulating relevant environmental performance information to capital markets, while (b) capital markets have failed to recognize the relevance of such information and consequently have not asked for it."[54] This communications gap is a result of legislated materiality standards. Under securities regulation, issuers make a subjective determination of whether a given fact or change is material by applying the "reasonable investor" test – whether a fact "would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available."[55] This assessment is greatly influenced by the issuer's own (often narrow) view of who constitutes a "reasonable" investor, and the historical bias amongst issuers against viewing such information as material *per se*. As the US Governmental Accountability Office report pointed out, without access to issuer

---

[49] General Accounting Office, Environmental Liability: Property & Casualty Insurers' Disclosure of Environmental Liabilities (Washington D.C.: GAO, 1993) cited in The Environmental Fiduciary at 16.

[50] Susan B. Hughes, Allison Anderson & Sarah Golden, "Corporate environmental disclosures: are they useful in determining environmental performance?" (2001) 20 *Journal of Accounting and Public Policy* 217-240.

[51] Susannah Blake Goodman & Tim Little, *The Gap in GAAP: An Examination of Environmental Accounting Loopholes* (Oakland, CA: The Rose Foundation for Communities and the Environment, December 2003).

[52] Michelle Chan-Fishel, *Third Survey of Climate Change Disclosure in SEC Filings of Automobile, Insurance, Oil & Gas, Petrochemical, and Utilities Companies* (Friends of the Earth, July 2004) available at http://www.foe.org/camps/intl/corpacct/wallstreet/secsurvey2004.pdf.

[53] Government Accountability Office, *Environmental Disclosure: SEC Should Explore Ways to Improve Tracking and Transparency of Information*, supra note 2.

[54] Alan Willis & Julie Desjardins, Environmental Performance: Measuring and Managing What Matters (CICA, 2001) at xiv.

[55] *TSC Industries, Inc. v. Northway Inc.*, [1976] 426 U.S. 428, 449.

records, it is difficult for those studying the issue of social and environmental disclosure to accurately assess what should have been reported and thereby evaluate the effectiveness of current materiality standards and reporting requirements. Similarly, the ability of the investor to independently assess the material significance of a given event is compromised.

5. Should social and environmental reporting be mandatory or voluntary?

The findings of the many studies cited above demonstrate that it is essential for social and environmental reporting (and indeed all reporting) to be clear, measurable, standardized, and comparable. Without exception, the authors of these studies conclude that this can only be achieved through mandatory reporting requirements.[56] Regulators and issuers have traditionally raised concerns about "the lack of any framework or set of rules and generally accepted practices for external reporting about environmental performance at a level of rigour and reliability comparable to that of financial reporting."[57] In response, the Global Reporting Initiative issued Sustainability Reporting Guidelines in 2002 which address many of these concerns and are emerging as the internationally recognized reporting framework.

6. Where should social and environmental information be reported?

There is some debate about whether social and environmental information should be included in an issuer's financial statements or reported separately in the MD&A. As the OSC Five Year Review Committee Final Report notes, there is an expectation that external developments and the effect of such events on a company be discussed in its interim and annual MD&A.[58] However, many investors contend that the material costs of social and environmental events must be determined and included in an issuer's financial statements wherever possible to ensure that they are considered by analysts and investors in valuing a firm. Within the existing reporting framework, it would be logical to have known risks and liabilities reported in the issuer's financial statements and have forward-looking information concerning potential risks and mitigation strategies identified in the MD&A. Regardless, these comments demonstrate the necessity for both qualitative and quantitative reporting in the appropriate regulated disclosures.

The CICA offers one possible reporting framework in the MD&A (see Appendix B).

7. How are issuers supposed to value social and environment events?

Quantifying the financial costs and benefits associated with past and future social and environmental matters continues to pose problems for reporting. It is well recognized that current accounting and reporting mechanisms do not adequately account for the operational and strategic risks and opportunities associated with modern enterprise.[59] The Financial Accounting Standards Board (FASB) notes that "improved business and financial reporting of the "new economy" will require attention to: ...Expanded and systematic use of non-financial performance metrics."[60] The American Institute of Certified Public Accountants' (AICPA)

---

[56] *See also* UNEP Finance Initiative, *supra* note 34; Standard & Poor's, SustainAbility and UNEP, *Risk & Opportunity: Best Practice in Non-Financial Reporting* (2004).

[57] Willis & Desjardins, *supra* note 52.

[58] *OSC Five Year Review Committee Final Report – Reviewing the Securities Act (Ontario)* (March 21, 2003) at page 151 available at http://www.osc.gov.on.ca/Regulation/FiveYearReview/fyr_20030529_5yr-final-report.pdf.

[59] *See e.g.* Willis & Desjardins, *supra* note 52; Wayne S. Upton, Jr., *Business and Financial Reporting, Challenges from the New Economy* (Norwalk, Connecticut: Financial Accounting Standards Board, April 2001).

[60] FASB Business Reporting Research Project (2001).

Special Committee on Financial Reporting recommended in a 1994 report "that business reporting must focus more on the factors that create longer term value, including non-financial measures indicating how key business processes are performing."[61] And the Canadian Institute of Chartered Accountants (CICA) has opined that "any new accounting model will likely incorporate both accounting for knowledge-based businesses as well as green accounting."[62]

Issuers argue that even if social and environmental information can be valued and is material, there is no accepted standard for quantifying the cost or benefit to the firm and investors. Companies that attempt to quantify such risks and opportunities run the risk of overvaluing risks or undervaluing opportunities creating distortions in performance and leaving management open to possible liability. Accounting practices for certain known environmental liabilities have been developed, particularly with respect to contaminated sites. Firms and the accounting industry have also developed methods for quantifying and do value certain "intangible" elements, such as goodwill, as a matter of course in financial statements. Meanwhile, efforts continue at both international and national levels to develop methodologies for valuing social and environmental information.[63]

8. What processes exist for independent verification of social and environmental disclosures?

As with all financial information, it is essential that social and environmental information must be subject to independent verification. Currently, the ability of financial auditors to evaluate the processes required to establish an understanding of the social and environmental issues affecting a company and to value the risks and opportunities associated with corporate social and environmental practices is limited, as it is with respect to all internal controls. The actions of certain leading companies has generated some momentum in the development of social and environmental quantitative auditing, however it is only with the introduction of mandatory disclosure requirements that we will see more rapid development of verification systems.

9. What will be the effect for issuers?

Issuers are concerned about the added burden that social and environmental reporting will have on their operations. Accordingly, they argue that mandating reporting of social and environmental information interferes with the economic imperative of business.

While companies will incur additional costs in setting up internal controls and conducting audits, these front-end costs can be reduced through the use of emerging reporting technologies. Uniform frameworks have been developed and implemented to simplify non-financial reporting by public issuers. For example, SRI World Group, Inc., a leading provider of corporate sustainability reporting solutions, recently announced the release of the second generation of OneReport, a global electronic reporting network that enables companies

---

[61] AICPA, *Improving Business Reporting - A Customer Focus* (New York: AICPA, 1994).

[62] Robert I.G. McLean, *Performance Measures in the New Economy* (Toronto: CICA, 1995). Available online at http://cpri.matrixlinks.ca/Archive/PMNE/PerfMeasNE.html.

[63] Repetto, *Pure Profit: The Financial Implications of Environmental Performance* (Washington D.C.: World Resources Institute, 2000) available at http://www.progressive-asset.com/pdf/repetto.pdf; Repetto, Coming Clean, *supra* note 39. *See also* Skandia AFS, Human Capital in Transformation, Intellectual Capital Prototype Report (1998), 4 available at http://www.skandia-afs.com/; Karl-Erik Sveiby, "The Intangible Assets Monitor" (1999) available online at http://www.sweiby.com.au/IntangAss/CompanyMonitor.html; Geoff Baum, Chris Ittner, David Larcker, Johnathan Low, Tony Siesfeld, and Michael S. Malone, "Introducing the New Value Creation Index," Forbes ASAP (April 4, 2000); CICA Total Value Creation TM (TVC®) System.

to systematically collect and manage their social, environmental, economic, and governance data and distribute this data to research and rating agencies, the financial community, and other stakeholders. OneReport cooperates with 22 research and rating agencies from around the world and allows for GRI-compatible reporting. These organizations have signed agreements to accept data directly from OneReport, eliminating the need for redundant sustainability surveys and other ad hoc data collection methods. This allows companies to report their data in one system and have the data distributed in standardized formats to multiple research and rating agencies and other data users simultaneously. Furthermore, associated costs decrease in subsequent years once systems are in place.

On the other hand, gains can be achieved through increased efficiencies derived from internal systems auditing, reduced insurance premiums and costs on borrowing, and improved investor and stakeholder relations.

10. Would not better enforcement of existing disclosure requirements be sufficient?

There is unquestionably a need for better enforcement of existing rules and regulations. However, studies cited above suggest that greater enforcement of general materiality standards may not be sufficient to provide investors with the information they require to assess social and environmental related risks. Enforcement of existing standards does not address the need for comparable reporting frameworks. Neither can regulators be expected to review the disclosures of all issuers. Standards that require issuers to disclose whether or not they have evaluated the material effect of social and environmental factors on their operations must also exist to allow investors to make independent assessments.

RECOMMENDATIONS TO THE OSC

From the above analysis, it is observed that Canadian regulation provides a starting framework for social and environmental disclosure, but the framework is not supported by guidance or enforcement. Capital markets would benefit from immediate efforts to bolster compliance with existing regulation with minimal effort by regulators and disruption to issuers. Further efforts could be made in the longer term to clarify reporting standards to enhance investor confidence. Accordingly, recommendations are grouped in two phases reflecting short-term and long-term objectives. Second phase recommendations could be considered following evaluation of the effectiveness of first phase recommendations.

First Phase Recommendations

1. Conduct CD reviews to evaluate the extent and veracity of reporting on social and environmental processes and events in order to more accurately assess compliance levels with existing disclosure rules.

2. Follow up with an OSC bulletin and Staff Notice reminding OSC staff and public issuers of existing disclosure requirements regarding social and environmental disclosure, including reference to NP51-201, MI52-109, MI52-111, CICA MD&A Guidance and draft Interpretative Release. Include examples of model and deficient disclosure on a range of social and environmental issues where possible.

3. Help facilitate and participate in educational offerings to raise awareness amongst market participants, including public issuers and financial analysts, about corporate social and environmental practices and corporate disclosure requirements.

4. Provide sector-specific interpretative guidance with respect to the "reasonable investor" materiality standard (once adopted), including the interpretation of both "material fact" and "material change" in regards to social and environmental information.

5. Increase communication between the Continuous Disclosure and Enforcement divisions of the OSC on matters related to non-financial (particularly social and environmental) disclosures and encourage enforcement of existing rules and standards following a CD review of social and environmental disclosures as one means of raising the profile of such disclosures amongst public issuers.

6. Strengthen item 5.1(4) in Form 51-102F2 to require an issuer to indicate whether or not they have implemented social and or environmental policies. Based on provisions in other jurisdictions, the following amended wording is recommended: "Describe the extent (if it all) to which your company has implemented social or environmental policies that are fundamental to your operations, such as policies regarding your company's relationship with the environment or with the communities in which it does business, or human rights polices, and the steps your company has taken to implement them."

Phase Two Recommendations

7. Incorporate by reference into Form51-102F1 (MD&A) the requirement to review and provide disclosure with respect to key performance drivers detailed in the CICA's guidance on MD&A. Also, clarify the timeframes for determining materiality in MD&A reporting.

8. Recommend to government amendments to disclosure standards to bring securities regulation in Canada in line with foreign jurisdictions. For example, consider adoption of prescribed minimum thresholds for materiality similar to Regulation S-K in the United States, and requirements for stakeholder consultation by directors of public issuers about what constitutes material information for each company as required of British issuers.

9. Consider expanding Multilateral Instrument 52-111 (Reporting on Internal Control over Financial Reporting) to include reporting on internal controls and disclosure controls and procedures with respect to non-financial reporting.

10. Adopt a standardized reporting framework for both quantitative and qualitative social and environmental information, such as the CICA's MD&A disclosure framework, to ensure disclosures are understandable and comparable.

11. Convene a special CSA committee to explore the various issues with respect to non-financial information disclosure identified in this brief.

APPENDIX A: CICA'S MD&A GUIDANCE – KEY PERFORMANCE DRIVERS

330 KEY PERFORMANCE DRIVERS

330.1 Readers of MD&A's need to understand the performance drivers that are critical to successful implementation of the company's strategy and achievement of its goals. They also need to know the measures and significant leading indicators used by management to monitor progress on these key performance drivers.

330.2 Recommended Practice:

The MD&A should: (a) identify the key performance drivers for the company, and each of its core businesses and segments; (b) explain their significance to strategies and results; and (c) define and discuss the related performance measures, and, to the extent useful to readers, leading indicators.

330.2.1 Key performance drivers are those activities, competencies and qualities in which superior performance and favourable results are essential for the company, core business or segment to achieve its vision and strategic goals. Key performance drivers may differ among companies, core businesses and segments. For example, while a key performance driver in all companies may be the need to be adaptable to their environments, MD&A readers need to know if some companies or businesses are more nimble and readily able than others to respond to market conditions.

330.2.2 There are a number of models for identifying and linking key performance drivers with strategic objectives, capabilities, results and risk. A good MD&A will identify an organization's key performance drivers and disclose the related measures and, to the extent useful to readers, disclose relevant leading indicators.

330.2.3 Discussion about performance measures should include their relevance, definitions, calculation methods and underlying assumptions. Any changes in the basis of their calculation from one year to another should be clearly disclosed, with restatement of comparative amounts as appropriate.

330.2.4 Examples of areas in which key performance drivers may be identified, and in which performance is accordingly measured, include:

- market share;
- research and development and new product development;
- cost containment and operating efficiency;
- workforce;
- workplace organization and culture;
- customer satisfaction;
- adaptability;
- leadership and governance;
- capacity and utilization;
- innovation;
- technology;
- reputation and brand equity;
- financing;
- safety;
- environmental responsibility; and,

- social responsibility."

"PRINCIPLE 3: Completeness and Materiality

To be reliable, MD&A's should be complete, fair and balanced, and provide information that is material to the decision-making needs of investors.

230.3 Information is material if it would be considered important by an investor, acting reasonably, in making a decision to invest or continue to invest in the company. Management's determination of materiality applies not only to financial results but also to all information, qualitative as well as quantitative, disclosed in the MD&A. Individual qualitative or quantitative items that, in themselves, may not be material, may become so when considered as elements in the larger picture. Management should resolve any doubt about materiality in favour of disclosure."

APPENDIX B: CICA'S MD&A GUIDANCE – DISCLOSURE FRAMEWORK

310.1 RECOMMENDED PRACTICE:
The MD&A should communicate in formation that helps users understand past performance and future prospects. Five key elements of the disclosure framework to achieve this are:

- the company's vision, core businesses and strategy;
- key performance drivers;
- capability to deliver results;
- results; and
- risk.

Information should be presented as an integrated continuum with emphasis given to linking relevant past performance to future prospects.

310.1.1 The recommended disclosure framework emphasizes a forward-looking view even in the analysis of past performance. In particular, such analysis should focus on the in sights derived from management's assessment of the extent to which past performance is a predictor of future prospects. The MD&A should also provide a prospective business analysis, which together with the historical analysis, forms a continuum of information, rather than stand-alone disclosures of distinct and unconnected data. Such a continuum explains the "why" behind both past performance and future prospects.

310.1.2 Following are the five elements of the MD&A disclosure framework:

310.1.2.1 Vision, Core Businesses and Strategy
What does the company do? What are its core businesses? Where does it operate? What is its long-term vision? What is the company's strategy for growth and shareholder value creation? What is its assessment of various factors, trends, opportunities and threats in the external environment and within the organization that shaped management's decisions about strategy? What is its revenue model?

310.1.2.2 Key Performance Drivers
What performance drivers are critical in creating value for the company's investors? In what matters must the company excel to fulfil its vision and strategy and achieve desired results? What performance measures are used to track the drivers and what key performance indicators are most useful to provide early signals regarding the drivers?

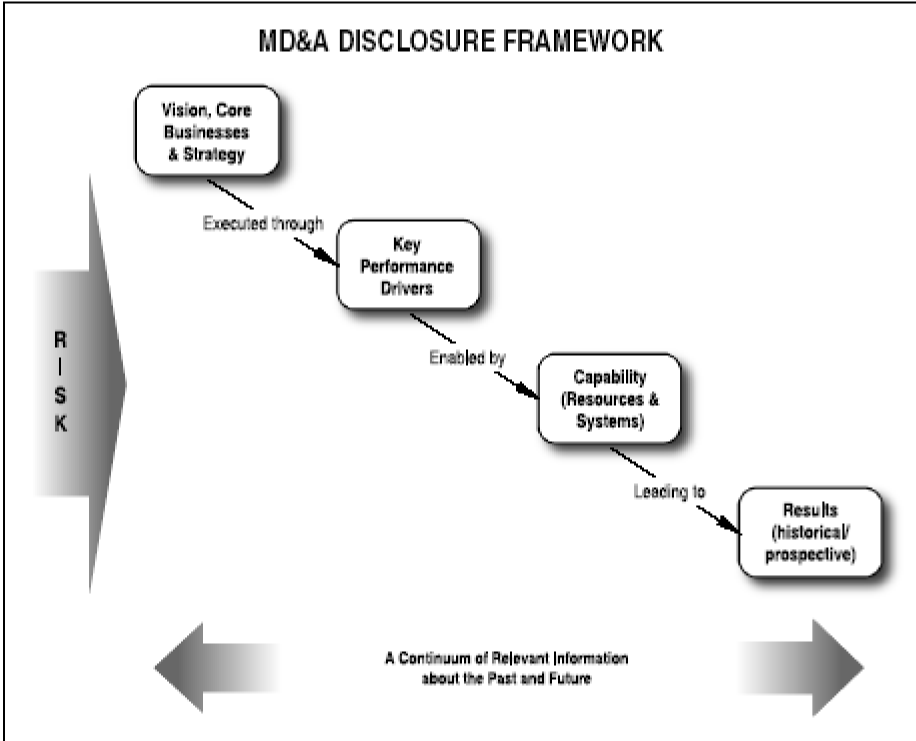
310.1.2.3 Capability to Deliver Results
What resources, financial and non-financial, are required to execute strategy and achieve desired results? What re sources does the company currently have? Are these sufficient? Will the company be able to obtain the re sources it needs in the future? Does it have the requisite systems and processes to execute strategy, man age risk and provide reliable disclosure to capital markets?

310.1.2.4 Results
How well has the company per formed recently and what are the underlying reasons for that performance? How do actual results compare to previously disclosed goals, objectives or targets? What trends does the company perceive going forward and what are the reasons for them? What are the future prospects for the company's performance? On what assumptions has management based its assessment of future prospects?

310.1.2.5 Risk
Risk and risk-taking are central to doing business and have implications for all four areas described above. What could alter management's plans? What are the principal business risks? How does the company identify and manage them? What are the measures of volatility used in managing risks? What is management's

assessment of the sensitivity of results given the principal risk scenarios? Are risk/re ward trade-offs measurable and reasonable?

Schematically these elements are seen as follows:



Excerpted with permission from CICA, *Management's Discussion and Analysis: Guidance on Preparation and Disclosure* (May 2004) at 310.

SELECTED RESOURCES

Canadian Institute of Chartered Accountants, *Management's Discussion and Analysis: Guidance on Preparation and Disclosure* (CICA: November 2002).

---------, *Interpretative Release: Disclosing the Financial Impact of Climate Change and other Environmental Issues* (draft)(CICA, March 2005) available at www.cica.ca/multimedia/Download_Library/Research_Guidance/MDandA_Business_Reporting/English/IR_2_draft.pdf.

Michelle Chan-Fishel, *Third Survey of Climate Change Disclosure in SEC Filings of Automobile, Insurance, Oil & Gas, Petrochemical, and Utilities Companies* (Friends of the Earth, July 2004) available at www.foe.org/camps/intl/corpacct/wallstreet/secsurvey2004.pdf.

Environmental Capital Markets Committee, US E.P.A., *Green Dividends?: The Relationship between Firms' Environmental Performance and Financial Performance* (U.S. EPA, May 2000).

Office of Regulatory Enforcement, "U.S. EPA Notifying Defendants of Securities and Exchange Commission's Environmental Disclosure Requirements" (October 2001) 4(3) *Enforcement Alert* available at http://www.rosefdn.org/images/EPA.Enforcement.Alert.pdf.

Environmental Services Group, Price Waterhouse, Accounting for Environmental Compliance: Crossroads of GAAP, Engineering and Government – Second Survey of Corporate America's Accounting for Environmental Costs (Pittsburgh, PA: Price Waterhouse, 1992).

Nicholas C. Franco, *Corporate Environmental Disclosure: Opportunities to Harness Market Forces to Improve Corporate Environmental Performance* (American Bar Association Section on Environment, Energy, and Resources, March 8-11, 2001)(not published).

Freedman, Martin and A.J. Stagliano, *Environmental Disclosure of Companies Involved in Initial Public Offerings* (1996) available at http://panopticon.csustan.edu/cpa96/papers.htm/freedman.htm.

Susannah Blake Goodman & Tim Little, *The Gap in GAAP: An Examination of Environmental Accounting Loopholes* (Oakland, CA: The Rose Foundation for Communities and the Environment, December 2003).

Global Reporting Initiative, *Sustainability Reporting Guidelines* (2002)

Government Accountability Office, *Environmental Disclosure: SEC Should Explore Ways to Improve Tracking and Transparency of Information* (Washington D.C.: GAO, July 2004)(GAO-04-808)

Sandford Lewis & Tim Little, *Fooling Investors & Fooling Themselves: How Aggressive Corporate Accounting & Asset Management Tactics Can Lead to Environmental Accounting Fraud* (Oakland, CA: Rose Foundation, July 2004).

Robert I.G. McLean, *Performance Measures in the New Economy* (Toronto: CICA, 1995). Available online at http://cpri.matrixlinks.ca/Archive/PMNE/PerfMeasNE.html.

Office of Enforcement and Compliance Assurance, U.S. Environmental Protection Agency, *Guidance on Distributing the Notice of SEC Registrants' Duty to Disclose Environmental Legal Proceedings in EPA Enforcement Actions* (Washington D.C.: EPA, 1998).

Marc Orlitzky, Frank L. Schmidt, Sara L. Rynes, "Corporate Social and Financial Performance: A Meta Analysis"(Social Investment Forum Foundation, December 2004) available at www.socialinvest.org/areas/research/Moskowitz/2004MoskowitSummary.pdf.

Robert Repetto, *Silence is Golden, Leaden, and Copper* (Yale School of Forestry & Environmental Studies, July 2004) available at http://www.yale.edu/environment/downloads/repetto_report_full.pdf.

-------, *Pure Profit: The Financial Implications of Environmental Performance* (Washington D.C.: World Resources Institute, 2000) available at http://www.progressive-asset.com/pdf/repetto.pdf.

Robert Repetto and Duncan Austin, *Coming Clean: Corporate Disclosure of Financially Significant Environmental Risks* (Washington D.C.: World Resources Institute, 2000) available at http://pubs.wri.org/pubs_description.cfm?PubID=3040.

Securities Exchange Commission, *Summary by the Division of Corporation Finance of Significant Issues Addressed in the Review of the Periodic Reports of the Fortune 500 Companies* (posted on SEC website 27February 2003) available at www.sec.gov/divisions/corpfin/fortune500rep.htm.

Stanford Lewis & Tim Little, *Fooling Investors & Fooling Themselves* (Oakland, CA: Rose Foundation, July 2004).

Standard & Poor's, SustainAbility and UNEP, *Risk & Opportunity: Best Practice in Non-Financial Reporting* (2004).

Stratos, *Corporate Disclosure and Capital Markets: Demand and Supply of Financially Relevant Corporate Responsibility Information* (Ottawa: Stratos, December 22, 2004)(draft). Final version to be available at http://www.nrtee-trnee.ca/eng/programs/Current_Programs/Capital-Markets/Capital-Markets_E.htm.

UK Accounting Standards Board, *Reporting Standard 1: Operating and Financial Review (Exposure Draft)*.

UNEP Finance Initiative, *The Materiality of Social Environmental and Corporate Governance Issues to Equity Pricing* (Switzerland: UNEP, June 2004) at p. 5 available at www.unepfi.org/work_programme/investment/materiality/.

United States Government Accountability Office, Environmental Disclosure: SEC Should Explore Ways to improve Tracking and Transparency of Information (July 2004).

Andrew White & Matthew Kiernan, *Corporate Environmental Governance* (Bristol, UK: Environment Agency, September 2004) available at www.environment-agency.gov.uk/commondata/acrobat/fi045webdoc_920701.pdf.

Alan Willis & Julie Desjardins, *Environmental Performance: Measuring and Managing What Matters* (CICA, 2001). Available at http://www.cica.ca/index.cfm/ci_id/10390/la_id/1.htm.