CHARTERED SECRETARIES AUSTRALIA

Leaders in governance

21 April 2006

The Honourable Chris Pearce MP
Parliamentary Secretary to the Treasurer
Parliament House
CANBERRA ACT 2600

Dear Chris

Distribution of annual reports

Chartered Secretaries Australia (CSA) is the peak professional body delivering accredited education and the most practical and authoritative training and information on governance, as well as thought leadership in the field. We are an independent, widely-respected influencer of governance thinking and behaviour in Australia and an expert commentator on issues affecting governance and legislation.

With over 8,000 members and affiliates representing the majority of public companies listed on the Australian Stock Exchange (ASX), members of CSA have a thorough working knowledge of the issues relating to annual reports, both their production and distribution. CSA also conducts in-depth research on issues of governance, including issues relating to annual reports.

CSA endorsement of proposal to introduce amendments to allow companies to make annual reports available on the Internet and require hard copies to be sent only to investors who request them

CSA fully endorses the Federal Government's proposal to amend section 314 of the *Corporations Act* (the Act) to provide that companies can satisfy the requirement for the distribution of annual reports and financial statements by providing an electronic version of the annual reports and financial statements on their corporate websites, with a statutory obligation to deliver a hard copy, free of charge, to any shareholder who requests it.

CSA recognises the importance of investors receiving adequate financial information regarding listed companies. We believe that the ability to review a company's financial statements electronically provides a cost-effective means for companies to provide financial information, and provides a benefit, furthermore, to shareholders and the community. The ability of technology to search through such documents for relevant information also makes electronic communication timely and efficient for shareholders.

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While the Act already provides for the distribution of shareholder information electronically, where the shareholder nominates to receive the information that way, CSA believes that companies should have the option of electing electronic communication with shareholders as the default form of communication for annual reports, with hard copy communication the exception in such circumstances.

Experience suggests that this change of onus will mean that the vast majority of shareholders will not request a hard copy of the report. CSA believes such an amendment will therefore provide significant efficiencies to all reporting companies, including cost reductions that will be in the best interests of shareholders. It will also ameliorate the shareholder experience of being burdened with unwanted amounts of hard copy corporate information in the mail, while at the same time providing a large benefit to the environment.

In the case of some smaller companies who may not have their own corporate websites, the existing statutory regime would remain as an alternative for them.

CSA would like to outline a number of positive benefits that accrue to the government's proposal, as well as to recommend enhancements to the proposal.

Summary of benefits of legislative change

The compelling reasons to support this proposal include:

- **Shareholder expectations have changed**

Shareholders want only specific and very concise information, such as short-form non-statutory financial reports. Yet increased regulation in recent years has greatly increased the length of annual reports, including concise reports. More than 39 per cent of shareholders in companies in the top 20 listed companies elected not to receive an annual report of any kind in 2005, and more than one-quarter of shareholders in Australia's top 200 companies elected not to receive an annual report of any kind in 2005.

- **Significant cost reductions for shareholders**

In 2005, the average cost of producing an annual report per shareholder in the top 20 listed companies was $6.83, and in listed companies in the second tier of the top 200 it was $9.31. With listed companies legally obliged to issue reports to shareholders who have not expressly declined to receive them (that is, three-quarters of shareholders in the top 200 listed companies), this is a very expensive exercise and an expense shareholders have to bear.

- **More efficient means of communication are now available**

Seventy per cent of households now have email and Internet access. An increasing number of shareholders that review company financial statements do so online or have the capacity to do so online, either on the company's website or the ASX website, or receive them via email direct from the company.

- **Environmental cost savings**

One tree produces enough paper for just 100 copies of an 83 page report (the average length of an annual report in the top 200 listed companies). However, the average print run for the top 200 listed companies is 186,000 copies, or 1,853 trees. It also takes more water to produce one ton of paper than for any other commodity.

- **Legislative precedent**

Members of bodies corporate (building societies, credit societies, credit unions and friendly societies) opt in to receive annual reports. When this legislative provision was brought in, members were asked to nominate whether they elected to receive annual reports. If members responded in the affirmative, this became a standing request, thus ensuring members were not obliged to request the annual report more than once. Members have clearly not been disenfranchised by the move to an opt-in provision.

Further research on the benefits accruing to the proposed legislative reform is provided in the following section.

Recommended enhancements to proposal

CSA proposes that, when filing their annual reports and financial statements with the ASX, listed companies would be obligated to include a covering announcement which confirms that the documents have been placed on the company's website for review, but that the company will provide a hard copy to any shareholder who requests it.

CSA also proposes that the amendment would enable any shareholder to make a standing election to receive a hard copy of the report each year, that is, the shareholder would not be required to repeat their request each year.

Background to benefits of legislative change

Current ASX listed company requirement in relation to the distribution of annual reports

Currently under section 314 of the *Corporations Act 2001* (the Act), all relevant companies, disclosing entities and registered schemes are required to distribute an annual report, including annual audited financial statements, to shareholders. Companies may elect to send shareholders a concise annual report in lieu of a full annual report.

Sections 314(4) and (5) of the Act allow such reports to be distributed to shareholders electronically where the shareholder nominates to receive the report that way. This may be done by sending the shareholder an electronic copy of the report or by placing the report on the company's website and sending the shareholder an email telling them that the report is available and how they can access it.

According to research undertaken by CSA, 62 per cent of listed companies also email to shareholders public announcements or a link to the company website.[1]

Under section 316 of the Act, shareholders may elect not to receive any material required to be distributed under section 314 of the Act or to receive the full annual report instead of a concise report.

Effect of current requirement[2]

Research conducted into the top 200 listed companies by CSA over a number of years has shown a declining number of shareholders electing to receive the full annual report. In 2005, only 19 per cent of shareholders in Australia's largest companies (which tend to have a higher proportion of 'Mum and Dad' investors) elected to receive the full annual report, down from 38 per cent per cent in 2003.

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[1] Chartered Secretaries Australia, *Benchmarking Governance in Practice in Australia 2006*

[2] All statistics quoted in this section are from Chartered Secretaries Australia, *Benchmarking Governance in Practice in Australia 2006*

Meanwhile, the introduction of the concise annual report has not met the needs of those who choose not to take the full annual report, with 35 per cent of shareholders in the largest companies electing to receive the concise annual report, down from 50 per cent in 2003 and 60 per cent in 2001.

More than 39 per cent of shareholders in companies in the top 20 listed companies elected not to receive an annual report of any kind in 2005, up from 29 per cent in 2003 and 27 per cent in 2001. On average, more than one-quarter of shareholders in Australia's top 200 companies elected not to receive an annual report of any kind.

This confirms that many shareholders simply do not see the annual report as a vehicle for meaningful corporate information. Yet, with listed companies legally obliged to issue reports to shareholders who have not expressly declined to receive them, that is three-quarters of shareholders, this is a very expensive exercise and an expense shareholders have to bear.

In 2005, the average cost of producing an annual report per shareholder in the top 20 listed companies was $6.83, and in listed companies in the second tier of the top 200 it was $9.31. These figures include production and distribution costs. In 2003 the cost per shareholder in the top 20 listed companies was $5.40 and in 2001 it was $5.90. For those companies in the second tier of the top 200 listed companies, the cost per shareholder was $7.80 in 2003 and $11.20 in 2001, revealing that the downward trend in costs for the majority of companies has sharply reversed and costs are once more escalating.

The costs of producing and distributing annual reports remain high. Increased regulation in recent years, in the form of having to prepare a statutory remuneration report and reporting on compliance with the ASX Corporate Governance Council guidelines, has greatly increased the length of annual reports, including concise reports. In the largest companies, these two disclosures alone count for well over 20 pages.

The increased length of such reports and the recognition by companies that the majority of shareholders want only specific and very concise information has led some companies to seek additional means of communication with their shareholders, such as introducing short-form non-statutory financial reports. The high success of such initiatives highlight that reform in this area is needed.

At present, companies spend a lot of money in the form of fliers and other communications in an effort to persuade retail shareholders to register for electronic communications. The drive to encourage retail shareholders has also spawned initiatives such as eTree, the collaboration between Computershare and Landcare Australia, where money goes to Landcare for the purposes of reforestation for each email address recorded. The money for this project comes from participating companies, which donate $2 per shareholder opting to participate. Computershare collects the donated funds from participating listed companies and passes them on to Landcare Australia, who facilitates payments to community landcare groups.

Details of benefits of legislative change

Environmental costs

In 2005, the average length of a concise annual report for the top 200 listed companies was 81 pages of A4 paper and the average length of a full annual report was 138 pages of A4 paper. The average print run for a concise annual report was 186,000 copies and the average print run for an annual report was 23,000 copies.[3]

[3] Based on a survey of annual reports in the top 200 companies conducted by CSA

Discussions with Landcare Australia reveal that one tree is the equivalent of 8,330 sheets of paper (at a weight of 100gsm).[4] On this basis, an 83 page report is one per cent of a tree, or, to look at it another way, one tree produces enough paper for just 100 copies of an 83 page report. This means that the average print run of 186,000 copies (for an 81 page concise annual report) is roughly the equivalent of 15,438,000 sheets of paper, or 1,853 trees.

Given that the trees used in paper production come from renewable forests, some might attempt to argue that the number of trees cut down to produce annual reports is not in itself a major concern. However, this ignores the fact that the primary environmental cost of annual report production in hard copy relates to the chemical bleaching processes and water use attached to paper production. Almost 1,000 organochlorines are produced in the chlorine bleaching process used by the pulp and paper industry. The health and environmental consequences of many of these chemicals have never been studied.[5]

It takes more water to produce one ton of paper than for any other commodity, according to Landcare. Added to this is the amount of water required to grow the trees in the renewable forests, as the trees involved require far more water than indigenous trees. Hence, the damage to the environment of producing annual reports in hard copy is considerable.

Access to the Internet

According to the latest statistics, 77 per cent of the population is now online. There has been a massive increase in Internet use in the last five years, up from 33 per cent in 2000.[6]

In 2004-05, 67 per cent of Australian households had access to a computer at home and 56 per cent had home Internet access. In 2004-05, home was reported to be the most popular site of Internet use, with 52 per cent of adults aged 18 years or over using this site. An estimated 29 per cent of adults aged 18 years or over used the Internet from work.[7]

As a result, CSA contends that an increasing number of shareholders that review company financial statements do so online or have the capacity to do so online, either on the company's website or the ASX website, or receive them via email direct from the company.

Legislative precedent

CSA notes that certain bodies corporate (financial institutions, building societies, credit societies, credit unions and friendly societies) are granted the power under the *Corporations Act* to reverse the onus on members to opt out of receiving annual reports, as provided in Part 12.6, sections 12.6.01-12.7.06. This Part modifies the application of section 314 of the Act.

Under these provisions, members opt in to receiving annual reports. The companies to which this Part applies sent a once-off letter to their members at the commencement of these provisions, asking members to nominate whether they elected to receive annual reports. If members responded in the affirmative, this became a standing request, thus ensuring members were not obliged to request the annual report more than once. The once-off letter to members clarified that a lack of response from members would be taken as electing not to receive the annual report. Any new member is sent the once-off letter asking if they wished to opt in to receiving the annual report.

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[4] < http://www.conservatree.com/learn/EnviroIssues/TreeStats.shtml>
[5] ibid
[6] Nielsen/NetRatings*, Internet and Technology Report 2004-05*
[7] Australian Bureau of Statistics, *Household Use of Information Technology, Australia 2004-05*, ABS cat. no. 8146.0, 2005

CSA notes that the Australian Securities & Investments Commission (ASIC) was satisfied that this process ensured members were not disenfranchised in the move from an opt-out to an opt-in choice in relation to the distribution of annual reports.

CSA further notes that the New York Stock Exchange (NYSE) has proposed a rule change to this effect for all companies listed on it, which is currently being reviewed by the US Securities and Exchange Commission.[8] The NYSE believes 'that the ability to review a company's financials electronically provides a more timely, efficient and cost effective method for companies to provide and investors to access current financial information'.[9] CSA believes that the NYSE's proposals are at the forefront of emerging best practice in this area and that Australia should follow this trend.

Conclusion

In preparing this paper, CSA has drawn on the expertise of the members of our national policy committee, Legislation Review Committee, all of whom are involved in the production and distribution of annual reports and with compliance with the *Corporations Act* and the ASX Listing Rules.

CSA congratulates the government on this proposal and looks forward to its implementation.

CSA will be issuing a media release on this matter and making this letter available on our website.

We would be happy to meet to discuss our suggested enhancements in more detail.

Yours sincerely

Tim Sheehy
CHIEF EXECUTIVE

cc Senator Penny Wong
Geoff Miller
Senator Ian Campbell
Jeffrey Lucy
Tony D'Aloisio

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[8] Securities and Exchange Commission, Proposed Rule Change. File No SR 2005-68
[9] ibid