



Corporate Accountability towards the Environmental Protection: A Comparative Analysis of Sri Lanka and United Kingdom

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Abstract

Corporate responsibility towards the protection of the environment has been a concept which has gained a higher level of concern in the contemporary business world since it is believed that modern companies tend to expand their responsibility not only towards increasing their income but also for the protection of the environment from business malpractices because well-established concepts like sustainable development have been the requirement of today's society despite the traditional methods of environmental protection. Thus, companies do believe that they are also having a role to play when it comes to achieving the goals of sustainable development since resources would be protected for future generations only if the generations of the present era use the resources wisely without compromising the future generation to meet their needs. Hence, this research is aimed at to determine whether the current Sri Lankan Companies Act No.07 of 2007 encompasses a liability on the directors of companies to protect the environment which will in turn impact on accomplishing the goals of sustainability. The research also seeks to ascertain the compatibility of the Sri Lankan legal framework with the legal system of the United Kingdom relating to the corporate responsibility towards the protection of environment. The research identifies that the Sri Lankan legal system contains statutory loopholes when it is compared to the UK system which made legally bound to consider the environment as an internal part of its business operations. Therefore, the research suggests that Sri Lanka should implement expressed

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legal provisions considering environment as a part of the sustainable survival of the companies by providing for mandatory obligations on the corporations to act towards the environmental protection.

Keywords: *Corporate Responsibility, Environment Protection, Sustainable Development, Sri Lanka Companies Act, UK Companies*

Introduction

The development of national economy of a country is basically based on the direct and indirect contribution of the corporate sector. These corporate sectors represent various types of industries such as agricultural, manufacturing, construction, petroleum, apparel, textiles etc. and each of these industries are operating through a continuous chain of steps which are important to the standard product. However, these operations can be found that making considerable harm to the environment of their activities at any stage. The duty attributed to such corporate sector is to minimize these threats. However, 'sustainability is rapidly becoming a mainstream component of corporate strategies to support 'triple bottom line' results focused on people, planet, and profit.'¹Therefore, company stakeholders are looking for companies to involve in sustainable practices which produce financial, social and environmental results. However, this pressure on the corporate sector, created the need of the development of the tools and measurements and data analysis which consistently report sustainability progress, risks and opportunities. Since stakeholders consider a business entity not only as an economic unit but also as a socio-economic entity, it has to operate in the socially acceptable behavior. It means organizations should address broader concerns such as the environmental impact of the company and adhere to the concept of corporate social responsibility, which is a self-

¹ A.M. Inun Jariya, 'Environmental Disclosures in Annual Reports of Sri Lankan Corporate: a content analysis' (2015) <https://www.researchgate.net/publication/328782639_Environmental_Disclosures_in_Annual_Reports_of_Sri_Lankan_Corporate_A_Content_Analysis> accessed 19 September 2022.

regulating business model that helps a company be socially accountable to itself, its stakeholders and the public.²

The statutory codification of directors' duties in Sri Lanka that can be found in the Companies Act of No. 07 of 2007 had not expressly recognized corporate duties towards the environment. However, Unlike Sri Lanka, the United Kingdom Companies Act 2006 has gone into great lengths in corporate governance in order to consider environment as a major part in corporate responsibility.

Therefore, the article aims to ascertain whether the existing legal framework in Sri Lanka recognizes the corporate accountability towards the environmental protection. However, when compared to the jurisdiction of the United Kingdom, the domestic legal background of corporate accountability in Sri Lanka does not contain adequate expressed provisions. Therefore, the author intended to make a comparative research that will serve to bridge this critical gap in the existing body of knowledge.

The paper will first introduce the corporate governance towards environment and secondly, it seeks to examine the existing legal framework of Sri Lanka that encompasses a liability on companies to the protection of the environment and then make a comparison between Sri Lanka and United Kingdom regarding the corporate responsibility towards the protection of the environment. Thirdly, the paper will lay down recommendations on how the Sri Lankan legal framework on corporate accountability should strengthen to protect the environment by focusing on legal system of The United Kingdom and the final part will lay down the conclusions of the paper.

Corporate governance towards environment protection.

A corporation as a legal entity is not only interested in financial concerns, but also concerns about the environmental impacts as well. The corporate

²ibid.

governance of directors' duties are more accountable to the environment pollution and degradation. Most of the corporations in today's world are profit based companies and their main aim is to maximize their profits. On that basis, these companies consider the environment as being outside the interests of a corporation. In the context of Sri Lanka, the Companies Act No.07 of 2007 does not expressly recognize the environment as a part of the business operations. However when compared to Sri Lanka, the United Kingdom companies Act 2006 expressly recognizes environment as a part of the interests of the corporation. In corporate governance, companies are managed and it ensures that it can control the whole decision-making process and balance the interests of all stakeholders. The whole responsibility in corporate governance ultimately rests on the board of directors which is equivalent to trustees and they are bound by fiduciary duties. In this corporate governance, the companies integrate with social and environmental concerns in their business operations and interactions with their stakeholders.

In most of the business companies, the corporate governance takes a Shareholder oriented approach which is based on the idea that the prime objective of a business is to increase profit, which leads to an increase in shareholder wealth.³ These profit oriented companies do not consider the corporate responsibility towards environment at large. Therefore, recent arguments have created on directors duties towards responsibilities that go beyond the shareholder interests to the company. ⁴As a result, the directors' duties are connected to every stakeholder who has interests in the company including suppliers, customers, society and the environment, a major parts of the business operations. However, Companies Act of Sri Lanka No. 07 of 2007 had not expressly recognized director's duties and corporate accountability towards the environment and unlike Sri Lanka, the UK legal system shows the positive behavior towards the concept

³ Stern, 'The shareholder versus the stakeholder approach-GRIN'(2017)<<https://www.grin.com/document/498235>> accessed on 29 June 2022.

⁴ ibid

of corporate accountability and disclosure of environmental and social sensitive information connected to the organization operations where it compares to the Sri Lankan context.

Exploring to what extent Sri Lanka and United Kingdom contributed to corporate responsibility towards the protection of the environment

In Sri Lanka, the Companies Act does not contain provisions which impose a mandatory duty on the corporations to disclose the positive and negative environmental impacts of the company through annual reporting. However, it is required to prepare financial statements by the companies as per sections 150 to 153 of the Companies Act of Sri Lanka. This has been emphasized in section 150(2) that, if in any case, the company miscarries this duty, every director in default shall be guilty of an offence⁵. Further, the act imposes a duty on corporations to abide to the rules and regulations when preparing the financial statements⁶. However, these sections do not execute a duty on the corporations to consider the environmental aspects when preparing the financial statements. However, the enclosure of the social responsibility statement in the company's financial statements might be a good move. The provisions of the Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995 impliedly recognize the act of environmental reporting and disclosure of such impacts to a certain limit through LKAS 01, LKAS 08 and LKAS 16. However, only a specified set of companies are liable in performing this conduct⁷.

Additionally, The Code of Best Practice on Corporate Governance which is a joint initiative between the Securities and Exchange Commission and the Institute of Chartered Accountants of Sri Lanka provides a valuable

⁵ Companies Act No. 7 of 2007.

⁶ Companies Act No.7 of 2007, S 151(1).

⁷ K.K Thilakasiri, 'Corporate Social Responsibility and Social, Economic and Environmental Development in Sri Lanka' (2013) Vol 8 Kelaniya Journal of Human Resource Management <<https://pdfs.semanticscholar.org/1c89/76f36185c84245326c7148c72166a884de52.pdf>> accessed 29 June 2022.

framework for environmental accountability⁸. According to the clause D 1.4 it is stated that the director's report shall contain the following criteria namely; the directors have complied with the best practices of corporate governance and an analytical review must be conducted covering financial, operational, risk management practices etc⁹. Further, another positive point is that, the annual report shall contain a 'Management Discussion and Analysis' which consisted of social and environmental protection activities carried out by the company, and the importance of sustainability reporting and the importance of the environmental governance¹⁰. Apart from that, as per this code the products of the listed companies shall be environmental friendly. However, this code is not a legislation and only the listed companies abide by the clauses of this code mandatorily and non- listed companies are not required to compulsorily carry out their business in par with this code.

In contrast, the United Kingdom Companies Act of 2006 has made it a duty of the corporations to assess the environmental impacts when carrying out business operations. Thus, UKCA has expressly imposed a duty on the directors to be accountable for eliminating the environmental harm. As a move for this, section 172 of UKCA requires the directors to act in good faith when dealing with company operations and this emphasizes a stake holder approach rather than a mere narrow share holder approach.¹¹ Further, a director shall be obliged to work for making his company a successful one while adhering to six factors as per the UKCA. First factor is to be aware of the consequences of any business decision that will have long-term consequences. The second factor is the need to strengthen the company's relationships with suppliers, customers, and others. The third factor is the interests of the employees of the company. The fourth factor is to be keen on the impact of company's operations on

⁸ Y.P Wijeratne and A.A Edirisinghe, 'Corporate Responsibility for Environmental Protection with Reference to the Companies Act No.7 of 2007 of Sri Lanka'(2018)<<http://www.kdu.ac.lk/dce/2015/10/17/irc-2018/>> accessed 29 June 2022.

⁹ Code of Best Practice on Corporate Governance 2017, clause D.1.4.

¹⁰ Code of Best Practice on Corporate Governance 2017, clause D.1.6.

¹¹ United Kingdom Companies Act of 2006, s 172.

the community and the environment. The fifth factor is the desirability of the company maintaining a reputation for high standards of business conduct and the final factor is act fairly among the members of the company¹². Thus, this section expressly recognized the director's duty to protect the environment and its resources and this would be a positive approach to determine that companies are progressively developing in a way which they believe that it is their responsibility to care for the environment. Since it is required to pay attention on the decisions taken by the company, it is assumed that companies are aiming at the long term sustainable growth. Section 187 of the Companies Act of SL has taken a similar approach as in section 172 of the UKCA. However, SL act does not make the director's duty bound to care for the environment and to enhance the paradigms of sustainable development.

Apart from that, in United Kingdom, directors shall prepare a director's report for each financial year.¹³ Further, a business review must be conducted by large scale and medium scale companies but small scale companies are not required to do such business review¹⁴. In case of a quoted company, it shall be necessary to determine the impact of the company operations on the surrounding environment when doing the business review. The business review must be to the extent necessary for an understanding of the development, performance, or position of the company's business include where an appropriate analysis using other key performance indicators including information relating to the environmental matters and employee matters¹⁵.

The aforementioned comparison depicts the fact that UKCA is in the frontline when it comes to protection of environment by the companies when compared with SLCA. However, it is still questionable as to whether the UKCA laws mentioned under the corporate governance is adequate to attain the sustainable development. Nevertheless, Sri Lanka could

¹² United Kingdom Companies Act of 2006, s 172.

¹³ United Kingdom Companies Act of 2006, s 415.

¹⁴ *ibid* 4, 417 (5) (b) (i).

¹⁵ United Kingdom Companies Act of 2006, s 417 (6) b.

learn a lesson from UKCA to make director's liable, if any harmful act occurs to the environment by way of a company's business operations. Furthermore, directors shall have to be liable in circumstances where there will not be any promotion, success or profit maximization to the company even though companies are vigilant on the environment degradation. Simply it gives the meaning that even in a situation where it is disadvantageous to the company operations, directors may have to be extremely conscious on preventing environmental destruction. Thus, this would be a modern day strategy to gain a sustainable future.

In today's Sri Lankan context, it is noticed that mostly the large scale companies like Hayley's group, MAS and Unilever, the 'Corporate Social Responsibility' has become a topic which came in to much discussion since those companies are taking their business decisions while considering the consequences of such decisions in the long run towards environmental protection, economic and societal development. According to Corporate Social Responsibility, A company should play a positive role in the community and consider the environmental and social impact of business decisions. It is closely linked to sustainability creating economic, social, and environmental value and ESG, which stands for Environmental, Social, and Governance. All three focus on non-financial factors that companies, large and small, should consider when making business decisions.¹⁶ Thus, this concept can be regarded as one of the essential perspectives of sustainability phenomenon. They both relate to the same spheres of enterprise impact, and enable achieving far-reaching social, ecological, and economical goals based on ethical standard.¹⁷ Hence, it would be grateful companies that should be encouraged to engage in performing Corporate Social Responsibility activities as financial growth of the companies would not only result in creating a sustainable future.

¹⁶ Nadia Reckmann, 'Corporate Social Responsibility – business news daily.com'(2022) <<https://www.bdc.ca/en/articles-tools/entrepreneur-toolkit/templates-business-guides/glossary/corporate-social-responsibility>>accessed on 29 September 2022.

¹⁷ Anna Zelazna, Matylda Bojar and Ewa Bojar, 'Corporate Social Responsibility towards the Environment in Lublin Region, Poland: A Comparative Study of 2009 and 2019'<<https://www.mdpi.com/2071-1050/12/11/4463>>accessed on 22 September 2022.

Eco-management in CSR is aimed at reducing negative impacts the businesses exert on the environment. The entities assume responsibility for ecological ramifications of their activities, strive to eliminate pollutions and emissions of harmful substances. This means that enterprises responsibly analyze their impacts on different resources and seek solutions that might minimize environmental burdens of their business operations. To this end, they stimulate their employees to save paper, energy, and water, and monitor the levels of produced emissions in order to stick to applicable emission norms.¹⁸

As a new trend of Corporate Social Responsibility, companies have to bear up the costs they utilized to conduct business activities without letting the community to bear those expenses. This philosophy highlights the environmental law concept 'Polluter Pays Principle' which means the polluter shall be liable for causing the environmental harm.¹⁹ This was upheld by the land mark case of ***Bulankulama V Secretary Ministry of Industrial Development***²⁰ by Justice Amerasinghe. Further, there are some developed countries which enable through an act or legislation and made it a mandatory duty for companies to spend certain amount of their annual profit for CSR activities. Hence, the companies are requested to spend some money on the community welfare and service which follows a human rights based approach, to spend such money on winning the labour rights and to achieve the long waiting goal of sustainable development²¹. In the case of ***National Roads and Motorists' Association Ltd V Geeson***²² it is highlighted that 'companies should act on the best interest of the whole community rather than solely acting

¹⁸ Anna Zelazna, Matylda Bojar and Ewa Bojar, 'Corporate Social Responsibility towards the Environment in Lublin Region, Poland: A Comparative Study of 2009 and 2019' <<https://www.mdpi.com/2071-1050/12/11/4463>> accessed on 22 September 2022.

¹⁹ Abhishek Gaur, Sangeeta Chaudhary, in Advanced Organic Waste Management, 'Polluter-Pays Principle - an overview | Science Direct Topics' (2022) <<https://www.sciencedirect.com/topics/earth-and-planetary-sciences/polluter-pays-principle>> accessed on 23 September 2022.

²⁰ SC Application No. 884/99 (F/R).

²¹ Y.P Wijeratne and A.A Edirisinghe, 'Corporate Responsibility for Environmental Protection with Reference to the Companies Act No. 7 of 2007 of Sri Lanka' (2018) <<http://www.kdu.ac.lk/dce/2015/10/17/irc-2018/>> accessed 29 September 2022.

²² [2001] 40 ACSR 1.

on behalf of the company's interest. In doing so, sometimes companies may have to engage in a certain act and vice versa'. Thus, it is evident that directors have a fiduciary duty towards protecting the environment.

Suggestions to Law Reform

It is pertinent to note that companies could expand their responsibility towards protecting the environment and as a positive drive for this even companies can organize awareness programs on the topics 'preserving the environment for future, the importance of core environmental principles like precautionary principle, polluter pays principles and conducting environmental impact assessments before carrying out business operations and public trust doctrine' because modern company law should not be restricted with traditional opinions as established in Anglo-American approach which a company shall act only towards the best interest of its creditors, shareholders and directors deprived of considering the environmental impacts. Based on the precautionary principle, companies should attempt to minimize the environmental degradation at the first stance while complying with CSR policies, rather than finding solutions after the environmental harm occurred. In the UK, the companies Act 2006 requires directors to consider the interests of employees, consumers, suppliers, the environment and the community when pursuing the interests of shareholders.²³ Hence, the author suggests that Sri Lanka Companies Act needs to be amended in order to include sections which ensures that every director and the company itself must involve in protecting the environment with complying with CSR policies as Sri Lanka is currently at the latter part of the list when compared with other jurisdictions.

²³ Li-Wen Lin, 'Mandatory Corporate Social Responsibility Legislation around the World: Emergent Varieties and National Experiences'(2020)<<https://blogs.law.ox.ac.uk/business-law-blog/blog/2020/11/mandatory-corporate-social-responsibility-legislation-around-world>> Mandatory CSR Duty under Corporate Law> accessed on 24 September 2022.

Moreover, the author suggests that, Sri Lanka should take steps to initiate requirements like submission of business review into company law and directors shall be made legally bound to present non-financial disclosures including the environmental impact assessment reports etc. Thus, this would directly impact positively on the sustainable development of the nation. Further, companies should be made legally bound to consider the environment as a part of their business and should not treat the environment as an outside element of the business. It is accepted that in stake holder approach, the corporations have an obligation to reveal about the impacts of the corporations activities on the environment to the general public. Section 426 of the UK Companies Act provides that all companies should prepare summary financial statements which will be derived from its annual accounts and through these annual accounts the directors consider a wider range of environmental impacts that are considered to characterize the responsible corporate behavior.²⁴

Hence, the author would recommend corporations to prepare annual accounts as these annual accounts include environment effects by their business operations and the public also can access information that would create a transparent governance on corporations.

Section 415 of the UK Companies Act 2006 requires directors to prepare a directors' report to each financial year of the company²⁵ and as specified by section 417(1), the directors' report must contain a business review.²⁶ It is an annual report of the company's business operations. This business review constitutes a comprehensive analysis of the performance of the company's business during the course of the year. Furthermore, according to section 417 (5) (b) I, the company review information about the environmental matters and this includes review on the positive and negative impacts of the company's business on the environment.

²⁴ John Dav, 'A guide to directors' responsibilities under the Companies Act 2006' (2007) <<https://www.accaglobal.com/content/dam/acca/global/PDFtechnical/business-law/tech-tp-cdd.pdf>> accessed on 19 September 2022.

²⁵ United Kingdom companies Act 2006.

²⁶ *ibid.*

²⁷Therefore, in order to know, whether the company acted beyond the company's interests and caused harm to the environment, this review helps to identify the issues caused by the relevant company.

According to Section 417 (6) (b), this business review includes an analysis using key performance indicators including information relating to environmental matters and employee matters.²⁸ Further, the UK Government has introduced Environmental Key Performance Indicators Reporting Guidelines for businesses carried out in their country.²⁹ For instance, if a company discharges chemical waste to the environment in day to day operations of the company it is not in the interest of the company, as it would ultimately breach the key performance indicators of the company. It identifies that the company's progress would depend on evaluating the impacts caused by company towards the environment. Moreover, if this business review indicates that the company acted accountable to the environmental sustainability that company perform well in their business. Therefore, the author suggests that as per the UK Company act, in Sri Lanka too directors of corporations should be required to prepare a directors' report in each financial year of the company and include a business review containing the analysis of information relating to the environment matters in their business operations.

Sri Lankan Companies Act No 07 of 2007 considered on corporate accountability discloses information regarding operations, but it did not indicate the environmental aspects at large. Although many countries in the world focused only on profit based approach and consider environment as outside the interests of the corporation, UK is more concerned on corporate governance on environmental aspects. Hence, it is important that lacking provisions in Sri Lanka should be adopted and the author suggests that it is essential to introduce express legal

²⁷ *ibid.*

²⁸ *ibid.*

²⁹ Sir Mark Moody-Stuart, 'A truly comprehensive review of sustainable development as it relates to organizations large and small' Reporting Guidelines for UK Business are available at <<http://www.defra.gov.uk/environment/business/envrp/guidelines.htm>>accessed on 29 September 2022.

provisions in the Companies Act considering the environment as part of the sustainable survival of the companies.

Environmental reporting is highly in need with the increasing challenges to the environment. With the development of industries worldwide, its ill effects have threatened the natural environment. Today more attention is focused on the environment locally, nationally and globally as this is becoming a grave problem. Environment is recognized as a scarce resource and a depreciating asset. Now the companies are being forced by civil societies and governments to pay more attention towards environment. It is a duty of corporations to protect the environment from pollution and degradation. The responsibility of protecting the environment mainly lies on the governments. As an amendment to the 1985 UK Companies Act, regulations on environmental disclosure for registered companies of Financial Times Stock Exchange (FTSE) were enacted in 2005 and Environment Agency of UK is on the view that 95 per cent of All-Share companies registered in FTSE, declare detailed information on their environmental impacts.³⁰ In Sri Lanka, the lack of provisions in the legal system is an impediment to environmental reporting. Hence, the author suggests that, it is necessary to establish Strong corporate laws on environment reporting to monitor and regulate activities of corporations towards the environment.

Conclusion

It shows the positive behavior of the UK towards this concept of corporate accountability and disclosure of environmental and social sensitive information connected to the organization operations where it compares to the Sri Lankan context. Though, the Companies Act of UK has clearly established the duty of operating this concept by establishing relevant legal provisions, Sri Lanka doesn't contain any such direct addresses in the Companies Act since it is the main legislature that governs the companies sector. But it must be mentioned that the Code of Best Practices (2017) has required the companies to reveal such information

³⁰The Companies Act 1985 Regulations 2005 [S.I. 2005/ 1011].

in their Annual Reports, but the issues are that it is only applicable to the listed Companies in Sri Lanka and it is not the main legislation that governs the company sector. A company should not consider the environment as outside the interest of corporation since in the present context the stakeholders are willing to consider environment as part of the company. Besides that, since the company must operate its activities with the acceptance of the society it is mandatory to satisfy the society's expectations. To that, companies must consider the environment as an internal part of it and operate by acquiring best practices in the industry. Therefore, in the end of this comparison it can be recommended to attribute the same effect in revealing relevant environmental sensitive information as a practice of the companies and establish suitable provisions in the Companies Act of Sri Lanka to mandate the companies to follow this practice as an obligation.