

australian**ethical** SUSTAINABILITY REPORT 2011



australian**ethical**[®] 

investment + superannuation

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'Never doubt that a small group of thoughtful, committed citizens can change the world. Indeed, it is the only thing that ever has.'

Margaret Mead

Courtesy of The Institute for Intercultural Studies, Inc., New York

About this report

Report profile

This is Australian Ethical Investment Limited's (Australian Ethical) tenth sustainability report and covers the period from 1 July 2010 to 30 June 2011. Australian Ethical has an annual reporting cycle. The previous report covered the period from 1 July 2009 to 30 June 2010.

This report is a statement of our commitment to the GRI process and can be downloaded from our website at australianethical.com.au/sustainability-reports.

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Report scope and boundary

Report boundary

This report describes the economic, environmental and social performance of Australian Ethical Investment Ltd (ABN 47 003 188 930) and Australian Ethical Superannuation Pty Ltd (ABN 43 079 259 733) for the year to 30 June 2011. It does not extend to the activities of the investments of the trusts and super fund managed by the Australian Ethical group.

The reporting of a number of environmental indicator aspects including materials, energy, water and waste is limited to Australian Ethical's main office in Canberra. It does not include the activities of staff working off site or at the Company's Sydney office. There has been no change in the report boundary since the previous reporting period.

Report scope

There has been no change in the report scope since the previous reporting period. A list of the GRI indicators covered can be found at: australianethical.com.au/sustainability-reports.

Data measurement techniques

Data has been measured, calculated and compiled according to the GRI G3 indicator protocols.

Restatements

Data that has been restated is identified in the text along with an explanation of the effect of any restatements and the reason for the restatement.

Assurance

Australian Ethical's 2011 sustainability report was formally reviewed by NetBalance. A report of this review was provided to the Directors of Australian Ethical and is at page 46.

Managing Director's statement



A decade of sustainability reporting

Australian Ethical continues to be the most deeply committed ethical fund manager in Australia. Our clients save and invest with us knowing that they are putting their money to work for a better world. Having strong ethical principles at the core of everything we do is a powerful uniting and motivating force for our clients, our staff and our shareholders.

This report marks a decade of sustainability reporting at Australian Ethical and I am very excited to present you with another high quality report. Through this report we share our environmental, social and governance performance during the financial year 2010–11.

We are proud to match this with ten years of reporting in line with the Global Reporting Initiative (GRI). The GRI develops and publishes guidelines that are used by companies and organisations worldwide as a framework for sustainability reporting. We have aligned our report with the G3 guidelines (GRI 2008). For an index of the report in line with the GRI G3 Guidelines, please see australianethical.com.au/sustainability-reports.

Any feedback and suggestions on the report are welcome. We aim to continue improving the presentation and quality of our report, please provide feedback through the form located at the back of this report or on the Australian Ethical website www.australianethical.com.au.

Supporting the community

Australian Ethical continues to lead its sector in philanthropy. Every year we donate 10 per cent of profit to charitable, benevolent and conservation purposes as part of the company's contribution to a positive and sustainable society. In 2011 the community grants pool increased to \$152,802 and was awarded to 22 charitable and conservation organisations. This brings the total amount gifted to

communities over the last 11 years to more than \$1.28 million. The 2011 community grants included two special project grants of \$35,000 each awarded to Carpets for Community and Men of the Trees.

We also continued to be a major sponsor and supporter of environmental and social justice events and organisations across Australia in 2010–11, including Sustainable House Day and the Walk Against Warming. Australian Ethical also became a major sponsor of the Australian Youth Climate Coalition. These events and organisations play a high profile role in educating people about the actions they can take to reduce their environmental impacts, and place pressure on business and governments to improve their environmental performance.

Invest for change

Our long standing ethical investment funds continue to promote sustainable business by pursuing a unique combination of financial and ethical objectives when selecting their investments.

During the year we also continued to focus on shareholder advocacy. Through the Climate Advocacy Fund we aim to encourage better climate performance, especially around carbon disclosure, by putting resolutions at annual general meetings of other companies listed on the ASX which promote sustainable business practices across Australia.

Our performance

The key environmental challenge we face directly as an organisation is reducing the amount of energy, water and paper used in our offices, as well as minimising the amount of greenhouse gas emissions and waste we produce. As demonstrated in the environment section of this report, we are leaders in the areas of energy and water efficiency, and offset the greenhouse gas emissions that we do produce. Last year we set a target to reduce our printer and photocopier paper use by 10 per cent, however, while we reduced paper use slightly we did not reach our ambitious target.

Our core values

Australian Ethical is, at its core, a values driven Company. Shortly after the close of the reporting period staff were invited to participate in the determination of a set of corporate values that bring the Australian Ethical Charter ("the Charter") to life – a set of values that we all identify with, guide our day to day behaviour and that are consistent with the Charter. The Company Values chosen by the staff were:

- Ethics,
- Integrity,
- Professionalism,
- Respect and
- Teamwork.

These values together with the Australian Ethical Charter are consistently applied across the Company and are inherent in the way we operate and interact with clients, society and the environment. This includes incorporation into client servicing and our relationships with third parties, as well staff position descriptions, surveys, performance review processes and development programs.

The ongoing instability in global financial markets means that these are challenging times for all financial services companies. These forces are significantly influencing how we operate and how we plan for the future. Australian Ethical is a unique 'true to label' business with a special point of difference that sets it apart from others.

These are also times when many opportunities will present themselves. We are, for example, well positioned for the introduction of the carbon pricing legislation. Due to our environmental screening, our portfolios have limited exposure to emissions-intensive activities, but businesses we invest in are likely to gain from a price on carbon. In addition, the proposed increase to the superannuation guarantee from 9% to 12% of salary will also benefit our business in the coming years.

Therefore, we are confident that with the right skills and attitude we will continue to carve out a special place in the investment and retirement landscape and be a leader in the sustainable investment community.



Philip Vernon
Managing Director

Company profile

Australian Ethical is an independent fund manager based in Canberra, Australia and was established in 1986 for the purpose of pooling investor savings, specialising in environmental and socially responsible investment. Australian Ethical originally managed a private ethical trust until 1989, when what is now the Australian Ethical Balanced Trust opened for public subscription.

Australian Ethical became a publicly listed company on the Australian Securities Exchange in December 2002. As at 30 June 2011 there were 50 employees and \$644.1 million in funds under management on behalf of over 19,000 responsible investors. Revenue for the year to 30 June 2011 was \$15,143,951, an eight per cent increase on the previous financial year.

Australian Ethical has a commitment to promoting ecologically sustainable and socially just enterprises using judicious investment throughout Australia and internationally. We currently manage seven retail unit trusts:

- Australian Ethical Balanced Trust (ARSN 089 919 255)
- Australian Ethical Smaller Companies Trust (ARSN 089 919 175)
- Australian Ethical Larger Companies Trust (ARSN 089 919 166)
- Australian Ethical Income Trust (ARSN 089 919 120)
- Australian Ethical International Equities Trust (ARSN 124 861 338)
- Australian Ethical Property Trust (ARSN 138 276 623)
- Climate Advocacy Fund (ARSN 140 444 211)

Australian Ethical's wholly-owned subsidiary, Australian Ethical Superannuation Pty Ltd, is the Trustee of the Australian Ethical Retail Superannuation Fund. The Australian Ethical Retail Superannuation Fund offers seven accumulation and six pension superannuation strategies:

- Defensive (previously known as the Income Strategy)
- Conservative
- Balanced (previously known as the Balanced Strategy)
- Smaller Companies (previously known as the Equities Strategy)
- Growth (previously known as the Large Companies Share Strategy)
- International Shares (previously known as the World Strategy)
- Climate Advocacy (accumulation strategy only)

All investments are managed to assist in:

- achieving a just and sustainable society
- protecting the natural environment
- providing a competitive financial return to investors

To do this, all investments are managed using the Australian Ethical Charter (see page 9) which aims to provide investment support to environmental and socially positive activities such as recycling, conservation, energy efficiency, preservation of endangered species, animal welfare, workplace relations and a range of related issues.

Under our constitution, before a dividend can be declared, 10 per cent of annual profits must be donated to non-profit, charity, benevolent and conservation organisations.

Review of operations

Australian Ethical's principal activity during the financial year was to manage seven public offer ethical managed funds (registered managed investment schemes). The controlling entity's wholly owned subsidiary, Australian Ethical Superannuation Pty Limited, was trustee of the Australian Ethical Retail Superannuation Fund during the financial year.

Australian Ethical and its wholly owned subsidiary, Australian Ethical Superannuation Pty Ltd, recorded a consolidated net profit after income tax expense for the year ending 30 June 2011 of \$1,282,533, a 25 per cent increase on the result of the previous financial year. Return on equity for the year is 17.1 per cent, up from 12.5 per cent in 2009-10. Earnings per share has increased 25 per cent to 128.8 cents per share and the cost to income ratio has reduced slightly to 87 per cent.

Average funds under management (FUM) grew by 5.5 per cent with the year end FUM (before distribution) being \$644 million compared to \$614 million for the prior year end. Our inflows have remained resilient in a tough managed funds market and grown by 2 per cent for the year ended 30 June 2011. Inflow growth has been centred around our superannuation fund. Inflow growth has been offset by a reduction in our entry fee margin as we adjust our business model to accommodate regulatory change (entry fee changes to our superannuation fund, implemented in May 2010).

The result was affected by two significant one-off issues:

- employment restructure expenses of \$445,000; and
- an Acquisition fee revenue of \$651,000 paid by the Australian Ethical Property Trust in relation to the purchase of Lawley House.

In a challenging market we continue to work on and improve our client service and marketing initiatives. During the year we in-sourced our superannuation call centre with all initial calls managed by Australian Ethical, enabling a better client service experience. We also made improvements to our website and introduced an online joining facility for our superfund, virtually doubling our new client numbers. During the year our sales and marketing area was restructured to address the challenges facing our industry.

At the year end, 30 June 2011, Australian Ethical's total equity was \$7,628,812. The company has no debt and is generating positive returns and cash flow. The company's market capitalisation as at 30 June 2011 was \$19 million.

There were no significant changes to the size, structure or ownership of Australian Ethical during the reporting period. The company's capital structure and policies remain relatively simple. The company currently has no debt and capital not required for working purposes is held primarily as an investment in Trevor Pearcey House.

Events subsequent to balance date

Since the end of the current reporting period global equity markets have experienced significant volatility as a result of uncertainties related to European sovereign debt and United States debt and budget management. A large proportion of the FUM managed by Australian Ethical is linked to domestic and international securities markets. This could potentially have a detrimental impact on company revenue for the coming financial year.

No other matters or circumstances have arisen since the end of the financial year which significantly affected or may significantly affect the operations of Australian Ethical and its controlled entity, the results of those operations or the state of affairs of Australian Ethical.

Investing ethically

Ethical investment is also known as sustainable investment and socially responsible investment. The term describes an investment process that, in addition to seeking a competitive financial return, incorporates environmental and social factors when selecting investments. In Australian Ethical's case, these factors are contained in the Australian Ethical Charter (page 9).

Australian Ethical has been specialising in ethical and sustainable investment for over two decades. Australian Ethical's product range includes ethical superannuation and managed funds, both offering a broad range of investment strategies.

Ethical and sustainable investors seek to benefit from investment in companies whose activities make a positive difference on a range of ethical, social and environmental issues. So aside from making personal efforts to reduce water and energy use, taking public transport and recycling, sustainable investment allows money to work towards achieving a sustainable society too.

While many sustainable funds only avoid certain stocks, Australian Ethical is unique in managing funds which actively seek investment in companies with superior environmental and social credentials. These companies are generally in industries such as renewable and efficient energy, organic foods, sustainable transport, recycling and water technologies.

Australian Ethical invests in approximately 150 entities through its screened managed funds. Investments cover equity (shares) in large and small enterprises as well as interest-bearing securities and property.

For over two decades Australian Ethical has produced competitive financial returns allied with strong ethical values.

Why it works

Taking account of a company's environmental, social and governance performance makes good investment sense. Over the long term companies that do better at managing their environmental risks and responsibilities should also perform better commercially.

The managers of the companies we select are more likely to think ahead, to care for staff, customers and the environment and to use resources wisely.

Sustainable investment screening helps avoid companies with a high risk of serious health, safety or environmental problems that in the future may lead to fines, compensation payouts and investor contempt.

Society is increasingly requiring business to account for the full environmental costs of production. This leads to an increased demand for sustainable goods and services, raising the profits of the firms that supply them. We believe sustainable industries are the industries of the future.

Our sustainable investments

Australian Ethical goes beyond offering just a 'one size fits all' sustainable/ethical investment option. Rather it offers a range of investment options suitable for different times of life and different financial circumstances. Options range from a conservative income fund through to higher risk share-based funds. Investment options are described in detail in disclosure documents.

All of Australian Ethical's screened investment options adhere to the same rigorous ethical criteria.

The Australian Ethical Charter[©]

All of Australian Ethical's investment decisions are aligned with our Charter. The Charter guides the sort of corporate activities that Australian Ethical seeks to avoid or support. The Charter contains both environmental and social components including specific human rights elements.

The Charter is also included in Australian Ethical's constitution at clause 2.1.

The Company will order its affairs so as to provide for and to support:

THE COMPANY WILL ORDER ITS AFFAIRS SO AS TO PROVIDE FOR AND TO SUPPORT:

- a. the development of workers' participation in the ownership and control of their work organisations and places
- b. the production of high quality and properly presented products and services
- c. the development of locally based ventures
- d. the development of appropriate technological systems
- e. the amelioration of wasteful or polluting practices
- f. the development of sustainable land use and food production
- g. the preservation of endangered eco-systems
- h. activities which contribute to human happiness, dignity and education
- i. the dignity and well being of non-human animals
- j. the efficient use of human waste
- k. the alleviation of poverty in all its forms
- l. the development and preservation of appropriate human buildings and landscapes.

THE COMPANY WILL ALSO ORDER ITS AFFAIRS SO AS TO AVOID ACTIVITY WHICH IS CONSIDERED TO UNNECESSARILY:

- i. pollute land, air or water
- ii. destroy or waste non-recurring resources
- iii. extract, create, produce, manufacture, or market materials, products, goods or services which have a harmful effect on humans, non-human animals or the environment
- iv. market, promote or advertise, products or services in a misleading or deceitful manner
- v. create markets by the promotion or advertising of unwanted products or services
- vi. acquire land or commodities primarily for the purpose of speculative gain
- vii. create, encourage or perpetuate militarism or engage in the manufacture of armaments
- viii. entice people into financial over-commitment
- ix. exploit people through the payment of low wages or the provision of poor working conditions
- x. discriminate by way of race, religion or sex in employment, marketing, or advertising practices
- xi. contribute to the inhibition of human rights generally.

Governance

The following section outlines Australian Ethical's governance structure and related policies, with particular emphasis on environmental, social and ethical issues. For further detail on Australian Ethical's corporate governance please refer to Australian Ethical's 2011 annual report and website www.australianethical.com.au.

Governance structure

Australian Ethical has a unitary board structure with one board of directors comprising non-executives and executives. The board is responsible for overseeing the company's goals and for developing strategic plans to achieve those goals. The Australian Ethical board (and its committees) have responsibility for the oversight and audit of the company's economic, environmental and social policies and procedures. The responsibility for implementation of these policies and procedures rests with Australian Ethical's CEO.

As at 30 June 2011 the board of Australian Ethical comprised six directors of which three were considered independent (Table 1).

Table 1: Australian Ethical board of directors during 2010–11

Name	Position	Appointed/resigned
James Thier	Executive, non-independent	Retired 17 November 2010
Howard Pender	Executive, non-independent	
Naomi Edwards	Non-executive, independent	Resigned 23 March 2011
Justine Hickey	Non-executive, independent	
Les Coleman	Non-executive, non-independent	
André Morony (Chair)	Non-executive, independent	
Phillip Vernon	Managing Director	Appointed 27 July 2010
Steve Newnham	Non-executive, independent	Appointed 20 December 2010

Committees

To assist in its work the board has established the following committees:

- Audit, Compliance and Risk
- People, Remuneration and Nominations
- Investment.

The role and composition of each committee as at 30 June 2011 is detailed below.

Audit, compliance and risk

The audit, compliance and risk committee provides a forum for the effective communication between the board and the external auditors. The role of the committee is to advise the board on the maintenance of an appropriate framework of financial internal control and appropriate discharge of 'trading company' fiduciary obligations for the company and its subsidiary, Australian Ethical Superannuation Pty Ltd. The committee is responsible for assessing and reporting on compliance against the compliance plans for the trusts. The committee is also responsible for reviewing the company's risk registers.

Membership: Ruth Medd (chair, independent non-executive director of Australian Ethical Superannuation Pty Ltd, a wholly-owned entity), Les Coleman (non-independent, non-executive director), Steve Newnham (non-executive, independent).

People, remuneration and nominations

The people, remuneration and nominations committee monitors adherence to guidelines set by the board in regards to remuneration arrangements and makes recommendations to the board on remuneration for the chief executive officer and non-executive directors. The committee is responsible for assessing the necessary and desirable competencies of directors, ensuring the directors have the appropriate mix of competencies to enable the board to discharge its responsibilities effectively, developing board succession plans to ensure an appropriate balance of skills and expertise is maintained and making recommendations to the board relating to the appointment and retirement of directors.

Membership: André Morony (chair, independent non-executive director), Justine Hickey (independent non-executive director)

Investment committee

The Investment committee oversees the processes which govern the investment of monies of the trusts for which Australian Ethical is the responsible entity and the investment of monies for which Australian Ethical has a mandate. The committee also oversees the ethics of investments, through developing a policy to ensure the consistent application of the Australian Ethical Charter and monitors product consistency with the Charter.

Membership: Justine Hickey (chair, independent non-executive director), Howard Pender (executive director), André Morony (independent non-executive director).

Board and director evaluation

The directors undertake an annual self-assessment of their collective and individual performance and seek feedback from the senior management team. A questionnaire concerning board and individual performance is completed by each director in respect of themselves and for each other director and the results are collected by the board chair. The board as a whole then considers and discusses the results of the questionnaire at a board meeting. The board chair also talks to each director individually about their performance and generally on the evaluation and comments received from their peers. The results of the questionnaire are examined from both a qualitative and quantitative perspective. Where discussed at a board meeting, results and any action plans are documented in board minutes. An assessment in accordance with the above process was undertaken in the relevant period.

Economic, environmental and social policies

Australian Ethical's vision

By its operations Australian Ethical will promote a sea-change in community-wide practice such that all investment will be undertaken with an ethical purpose as well as in pursuit of competitive return for chosen risk.

Australian Ethical's mission

Australian Ethical's mission is to provide those investors who share our social and environmental aims (as set out in our charter) with the means to earn a competitive return for chosen risk whilst at the same time contributing to a just and sustainable human society and the protection of the natural environment.

In addition to managing every investment according to the Australian Ethical Charter, Australian Ethical aims to conduct its operations in accordance with the tenets of the Australian Ethical Charter as well. In particular it aims to:

- ensure promotional material is comprehensive, transparent and readily understood
- achieve a high standard of administrative service for investors in our products
- ameliorate wasteful or polluting practices in business operations
- encourage, care for and provide educational opportunity for fellow workers, respect their individual needs and aspirations
- nurture staff participation in the ownership and control of Australian Ethical

Australian Ethical Charter

The board is required to further the aims set out in the Australian Ethical Charter as incorporated in the Australian Ethical constitution. The Charter sets out 23 ethical principles applied across the entire operations and activities of the company (see page 9).

Values

A company's values shape its culture, define its character and act as a guide as to how we behave and make decisions. Australian Ethical is, at its core, a values driven Company, our values being shaped by the Ethical Charter which guides the overall affairs of the company. The Charter however does not necessarily translate into easily digestible guides for day to day behaviour.

Staff were invited to participate in the determination of a set of company values that bring the Charter to life – a set of values that we all identify with, guide our day to day behaviour and that are consistent with the Charter.

Eighty six per cent of staff participated in the process by voting for the values that meant the most to them. The Company Values chosen by the staff were Integrity, Respect, Ethics, Professionalism and Teamwork.

The above statements, policies and values are consistently applied across the Company and are inherent in the way we work. This includes incorporation into position descriptions, staff surveys, performance review processes, induction programs and discussion at staff meetings.

Code of conduct

Australian Ethical's code of conduct has been endorsed by the board and applies to all employees and directors. The code provides professional and ethical standards expected by the company. Australian Ethical always seeks to adhere to the code in dealings with stakeholders. The company strives to achieve conduct that is over and above best practice.

Specific standards of conduct throughout 2010–11:

- we must be aware of conflicts
- we must not participate in insider trading
- we must not make unauthorised gains or payments
- we must only use company assets as authorised
- we have an obligation of care and diligence
- we must protect confidential and personal information
- we must ensure everyone has an equal opportunity
- we must compete fairly
- we must take into account any environmental, health and safety impacts before making any business decision
- we must not make unauthorised public statements

- we must not make unauthorised political donations on behalf of Australian Ethical
- we must be familiar with policies and procedures that relate to our work
- we have responsibilities to shareholders and the community

The full version of the Australian Ethical code of conduct and its share trading policy can be found on Australian Ethical's website www.australianethical.com.au. The code was last updated on 27 August 2008. A whistle blowing support policy guides employees on how to disclose or alert the company on any individual or organisational malpractice. The company's external counselling service may be used by employees to discuss and consider their personal position if unsure about procedures relating to the code of conduct or any other company policy.

The board has also adopted a separate policy for the management of conflicts of interest. The company's compliance officer maintains a conflict of interest register which is reviewed by the board and audit, compliance and risk committees. Details on board responsibility and the independence of directors are documented in Australian Ethical's 2011 annual report (pages 8–10).

Remuneration

Non-executive directors:

The general meeting sets the aggregated amount of remuneration payable to Directors. Fees paid to individual directors are determined by the Board, within the approved aggregated amount. The Chair received the highest amount, with all other directors receiving a lesser, equal amount. Remuneration of non-executive directors is determined through market data analysis of similar businesses operating in similar industries and recommendations made by the People, Remuneration and Nominations Committee. Australian Ethical has no explicit links between director remuneration and key social and environmental performance indicators. Details of the remuneration paid to directors and specified executives during the 2010–11 financial year are set out in the director's report within the 2011 annual report (pages 22–27).

Senior managers and executives

Australian Ethical aims to build and sustain its workforce with competitive remuneration and a diverse range of benefits. The aim is to attract, retain and motivate the talent pool capable of delivering our business strategy. All employees, including senior managers and executives, are treated equitably in regards to remuneration. This includes market data analysis, annual performance reviews and internal policies regarding remuneration and employee benefits. Further details on remuneration of senior managers, executive directors and group executives are set out in Australian Ethical's 2011 annual report (pages 23–27).

Performance-based remuneration and company performance:

During the reporting period, the remuneration of five senior executives and three investment staff included an 'at risk' component linked to agreed performance criteria. There was no explicit linkage between the performance criteria set and key social and environmental performance indicators (see details in 2011 annual report, pages 20–21).

All permanent staff also have the opportunity to participate in the employee bonus plan which is determined on the company's profit for the year. Australian Ethical encourages employee equity in the company through the ownership of shares. This is achieved through the opportunity of both short and long term incentive plans. Details of the employee share ownership plan and options issued under the plan are set out in the director's report within the 2011 annual report (page 57).

Staff remuneration is not explicitly linked to key social and environmental performance indicators.

Risk management and identification

The company has established policies for the oversight and management of material business risks. The company's risk management guide is available from the corporate governance section of the company's website.

The board has required management to implement a risk management system consistent with the company's risk management guide and to report to it on whether material business risks are being appropriately managed. During the relevant period, management has reported to the board's audit, compliance and risk committee and directly to the board as to the effectiveness of the entity's management of its material business risks.

The Managing Director and risk management officer certify to the board that its internal control and risk management systems are operating efficiently and effectively throughout the group.

Commitments to external initiatives

Precautionary principle

Australian Ethical has adopted the precautionary principle. The precautionary principle dictates that if an action or policy might cause severe or irreversible harm to the public or to the environment, in the absence of a scientific consensus that harm would not ensue, the burden of proof falls on those who would advocate taking the action. Examples of Australian Ethical's use of the precautionary principle include the application of the Charter to all investment decisions, being a signatory to the UN Principles for Responsible Investment, and involvement with a number of other sustainability initiatives and associations.

External initiatives

Australian Ethical recognises the importance of supporting external initiatives which promote a sustainable future in ways which are relevant to Australian Ethical's goals and activities; as such Australian Ethical is a signatory to the following initiatives:

- Carbon Disclosure Project
'The Carbon Disclosure Project launched in 2000 to accelerate solutions to climate change by putting relevant information at the heart of business, policy and investment decisions' (CDP 2011)
- UN Principles for Responsible Investment
'The PRI aim to help investors integrate consideration of environmental, social and governance (ESG) issues into investment decision-making and ownership practices, and thereby improve long-term returns to beneficiaries.' (PRI 2011)

Association memberships

Australian Ethical also holds memberships in various associations and industry bodies related to the superannuation and the ethical investment sector; the advancement of equal opportunities and employee satisfaction; and customer service. Australian Ethical or its subsidiary Australian Ethical Superannuation, are members of the following industry and business associations:

- Association for Sustainable & Responsible Investment in Asia (ASrIA)
Australian Ethical is a founding member of ASrIA – 'a not-for-profit, membership association dedicated to promoting corporate responsibility and sustainable investment practice in the Asia Pacific region.' (ASrIA 2011)
- Association of Superannuation Funds of Australia Limited (ASFA)
'ASFA is a not-for-profit, non-party political and non-sector aligned association representing the whole

industry including fund members, service providers and all types of superannuation funds (retail, industry, corporate and public sector).' (ASFA 2011)

- Australian Employers Network on Disability
'The Australian Network on Disability (AND) is a not-for-profit organisation resourced by its members to advance the inclusion of people with disability in all aspects of business.' (AEND 2011)
- Responsible Investment Association Australasia (RIAA)
'The Responsible Investment Association Australasia (RIAA) is the peak industry body for professionals working in responsible investment in Australia and New Zealand.' (RIAA 2011)
- Financial Ombudsman Service
'The Financial Ombudsman Service provides accessible, fair, and independent dispute resolution for consumers and financial services providers.' (FOS 2011)
- Global Reporting Initiative (GRI)
'The Global Reporting Initiative (GRI) is a network-based organization that produces a comprehensive sustainability reporting framework that is widely used around the world.' (GRI 2011)
- The Financial Services Council (FSC)
'The Financial Services Council's mission is to represent the interests of our members, our members' clients and customers, all investors and superannuation fund members and life insurance policy holders.' (FSC 2011)
- Investor Group on Climate Change Australia/New Zealand (IGCC)
'The IGCC represents institutional investors, with total funds under management of approximately \$700 billion, and others in the investment community interested in the impact of climate change on investments.' (IGCC 2011)
- IPS Worldwide
'IPS Worldwide is a human resource, risk management and wellness company providing high quality human capital solutions to leading organisations. IPS Worldwide is committed to pushing the envelope by leading development and innovation in tailored workplace programs that assist organisations better manage their human resources, improve the productivity of their employees and their experience of the workplace.' (IPS Worldwide 2011)
- US Interfaith Center on Corporate Responsibility (ICCR)
'Through the lens of faith, ICCR builds a more just and sustainable world by integrating social values into investor actions.' (ICCR 2011)

Stakeholder engagement

Stakeholder identification

Australian Ethical uses the Australian Ethical Charter as the starting point for identifying stakeholders. To identify key stakeholders we went through a stakeholder mapping process identifying a broad list of stakeholders who may be impacted by our operations. This list was then narrowed down to a list of key stakeholders based upon the objectives of the Charter and the values and goals set out in the company's corporate vision and mission statements. Australian Ethical's primary stakeholders include managed fund investors, superannuation members, financial advisers that receive information on the company's products, shareholders, employees, enquirers, the local community, the general public, investee entities and suppliers. The company also identifies the environment and future generations as stakeholders in the company.

Approaches to stakeholder engagement and response to concerns

Employee engagement

Staff are encouraged to provide feedback in relation to their job role, improvement opportunities or the company in general at any time. This feedback can be provided to their Manager, Senior Management, Human Resources or the Employee Representative.

In early 2011, feedback was received regarding concerns around staff morale following a period of some change across the organisation.

To address these concerns, practical solutions were put in place to resolve any concerns staff may have. These included the introduction of a Managers Forum for middle management so they could keep their staff informed of strategy and relevant corporate information and provide feedback and input into business issues; meetings between the employee representative and senior management; bi-annual lunches between staff and the Board, and celebrating success in the organisation.

Staff at Australian Ethical elect an Employee Representative every two (2) years to facilitate communication between staff, senior management and the Board.

The company has also taken the opportunity to engage with employees through monthly staff meetings, fortnightly team meetings, annual staff offsite meeting and a biennial staff survey.

2011 Staff survey

Australian Ethical conducts its staff satisfaction survey on a biennial basis. Having conducted a review in 2011, the next review is due in 2013.

Seventy three per cent of staff participated in this year's survey which is an increase on both the 2009 and 2008 surveys. Overall, the survey showed that Australian Ethical staff are satisfied with their employer and employment arrangements.

Areas showing a very high satisfaction rating included satisfaction with current roles, opportunities to use skills and abilities, enjoying work, being proud to work at Australian Ethical, a sense of accomplishment from work, commitment to the Ethical Charter, opportunities to make suggestions for improvements at work and feeling valued.

Table 2: Employee survey results for 2008, 2009 and 2011

Measure	Year	Employee Responses (%)		
		Disagree or Strongly Disagree	Unsure	Agree or Strongly Agree
Satisfaction with current role	2008	7	16	77
	2009	13	8	79
	2011	3	0	97
Satisfaction with Communication	2008	14	12	74
	2009	15	31	54
	2011	17	6	77
Learning & Development Opportunities	2008	5	21	74
	2009	10	31	59
	2011	14	23	63
Remuneration	2008	21	16	63
	2009	27	10	63
	2011	25	29	46
Employee Benefits	2008	4	12	84
	2009	5	24	71
	2011	8	20	72
I feel personally valued at work	2008	-	-	-
	2009	-	-	-
	2011	9	12	79

Those areas with a lower satisfaction rating included working in isolation to others, access to development opportunities and remuneration.

Sustainability committee

The Australian Ethical sustainability committee was established in 2002 and plays an important role in addressing sustainability issues within the company. The committee consists of members from various areas within Australian Ethical, ensuring a cross-section of the organisation is represented. The committee meets on a regular basis to develop and implement economic, environmental and social company policies and initiatives. During 2010–11 the sustainability committee was involved in the following initiatives:

- selection of the two major community grant recipients
- the company's sustainable transport days and participation in the National Ride to Work Day
- participation in the National Sustainable House Day
- promoting sustainable transport outside of the company's sustainable transport days
- sustainability presentations at staff morning teas
- maintaining the company's sustainability library
- providing support for the company's blood donation initiatives

Volunteering

On top of its own commitment to various charitable and community organisations, Australian Ethical encourages staff to volunteer time to organisations whose aims and activities are consistent with the Charter. Under the company's volunteering policy, staff can take one full paid day off a year (or blocks of time equivalent to one day) to volunteer with approved organisations. Australian Ethical also supports staff engagement with the community. In the last year staff organised and supported various initiatives including Lunch for Leukaemia, Movember and the Vinnies CEO Sleep out.

Engagement with shareholders

Australian Ethical strives to engage with its shareholders on a number of levels. Shareholders are encouraged to write letters to the company secretary, investment committee or the board to facilitate shareholder communication.

Australian Ethical includes a question section in the annual general meeting (AGM) meeting notice sent out to shareholders to encourage shareholder feedback.

At the AGM held on 17 November 2010, the company received no written questions by stakeholders. In previous years Australian Ethical responded to topics raised by stakeholders including:

- investment in alternative medicines
- shareholder engagement
- investment methodologies
- executive remuneration

Engagement with enquirers, managed fund unitholders and superannuation members

Australian Ethical strongly values the views, enquiries and opinions of all of its stakeholders and welcomes any feedback. We also encourage and welcome direct enquiries from unitholders and superannuation members. In 2010–11, direct enquiries encompassed issues such as climate change, wind farms, coal seam gas, uranium mining, animal welfare, genetic manipulation and biomimicry. Australian Ethical and our ethical research provider CAER respond to all unitholder enquiries addressing concerns such as the ones described above. Internal management reports track the number and type of enquires. The triennial stakeholder survey was undertaken in 2009–10; details on the survey approach are disclosed in our 2010 sustainability report on p16.

Australian Ethical hosts roadshows around the country to engage with external stakeholders and promote ethical investment. There were 27 road shows in 2010–11. Ten of the road shows were held in regional areas, which are often ignored by other fund managers. These road shows provide unitholders, superannuation members, shareholders and other stakeholders an opportunity to engage directly with the company. We engage with advisers on an on-going basis.

Australian Ethical also directly engages with unitholders, superannuation members and shareholders through its twice yearly newsletter Aim High. The newsletter includes articles of interest on sustainability, investor and staff profiles and discussions of fund performance.

Engagement with broader stakeholders

Australian Ethical recognises its connection with the broader community, environment and future generations. We endeavour to engage with these stakeholders in the following ways:

- providing tours of the company's six green star rated headquarters to demonstrate the concept of applied green building and workplace sustainability
- providing paid leave to all employees to volunteer for charitable and community organisations
- donating 10 per cent of the company's profit through the Australian Ethical community grants program
- ensuring all investment decisions are consistent with the Australian Ethical Charter

Accessibility

Australian Ethical believes that we have an obligation to provide information about our financial services in a clear, user-friendly way.

Australian Ethical attempts to present our investment product information as clearly as possible with as little legal small print as possible, adhering to the principle of fair design.

Our Aim High newsletter (two editions per year) contains informative investment information and aims to keep our managed fund and super members up to date with investment issues.

Our people

For over 20 years of operation Australian Ethical's work culture has been shaped by the values set out in the Charter (page 9). This section reports on how Australian Ethical provides a stimulating work environment and our continuing strong performance in this area.

Australian Ethical workforce

Australian Ethical employed 50 staff at 30 June 2011, working across the company in areas including superannuation, investment, trust administration, relationship management, accounting, information technology and marketing. Staff numbers remained relatively stable during 2010-11 (50 at 30 June 2011 compared with 52 at 30 June 2010). The number of full time equivalent (FTE) staff at 30 June 2011 was 46.64, slightly down from 47.8 at 30 June 2010.

At the end of the reporting period Australian Ethical had 50 employees (46.6 FTE). This represents a decrease of 2 since the start of the reporting period; a 3.8 per cent decrease. The net FTE change was -1.2 or, in percentages, -2.3 per cent.

At the end of the reporting period 80 per cent of Australian Ethical's workforce were full time, with the remaining 20 per cent part time. The majority of staff (84 per cent) are based in the Canberra office. Of the remaining 16 per cent, one person is based in Brisbane and one other in Melbourne; all the rest are located in Sydney.

Table 3: Australian Ethical workforce by employment type, employment contract and location

Our workforce	Financial year		
	2008-09	2009-10	2010-11
Permanent staff by employment type			
Full-time	36	39	40
Part-time ¹ – number of staff	15	10	10
Part-time – FTE	10.2	6.6	6.64
Employment contract			
Permanent – number of staff	51	49	50
Permanent – FTE	45.8	45.6	46.64
Fixed term or temporary – number of staff	2	3	1
Fixed term or temporary – FTE	1.6	2.1	1.0
Employment location			
Canberra office – number of staff	44	42	42
Canberra office – FTE	39.0	38.6	39.34
Other – number of staff	9	10	8
Other – FTE	8.4	9.1	7.3

¹ Including casual employees of Australian Ethical.

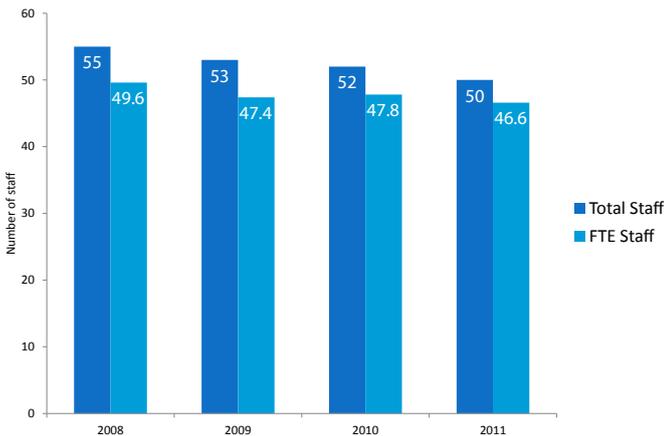


Figure 1: Australian Ethical workforce – trend by total staff and FTE staff

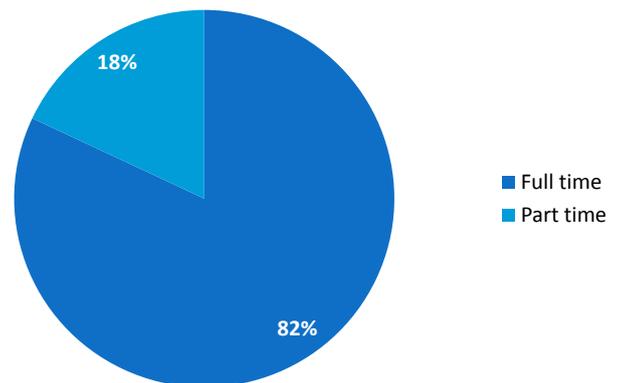


Figure 2: Australian Ethical permanent employees by employment type as at 30 June 2011

Table 4: Gender composition of corporate governance bodies and by employee categories

Category	Balance date					
	30 June 2010			30 June 2011		
	Total	% Male	% Female	Total	% Male	% Female
Australian Ethical board	6	67	33	6	83	17
AES board ¹	4	50	50	4	50	50
Management	10	90	10	12	84	16
Professional	19	89	11	17	76	24
Support	23	39	61	21	43	57
Total	52	67	33	50	64	36

¹ Australian Ethical Superannuation Pty Ltd (AES) board

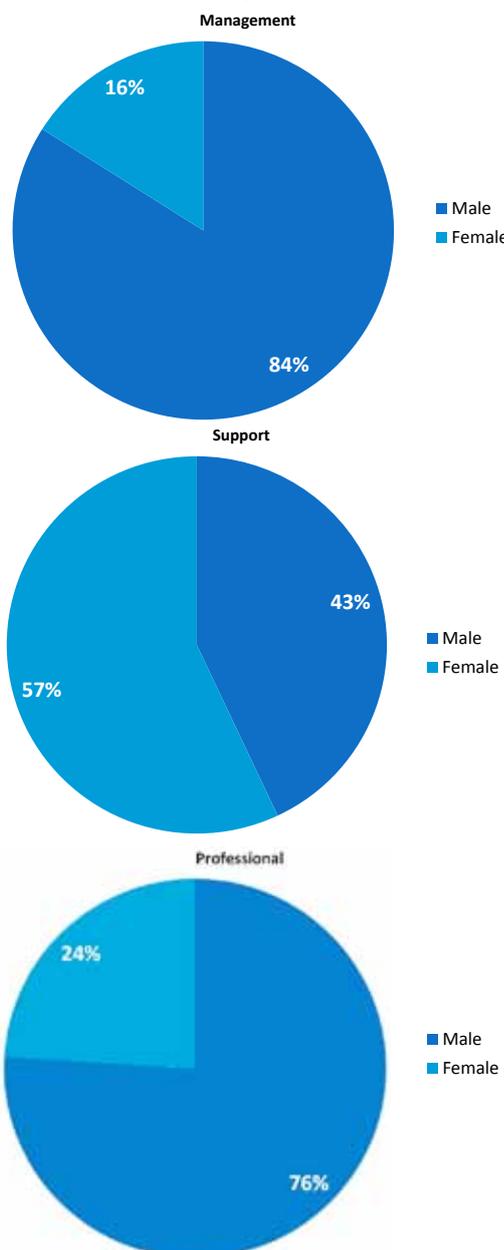


Figure 3: Gender composition by employee category as at 30 June 2011

Pay equality is a meaningful indicator to assess not only gender equality in the workplace but Australian Ethical's commitment to equal pay for equal work. Market rates continue to be lower for female employees compared to their male peers.

The ratio of the pay for female to male employees in 2010–11 varies between 65 per cent and 91 per cent. The largest pay gap remains in management where females earn 65 per cent of their male counterpart's basic salary. This is a slight increase on 2009–10 where the ratio was 60 per cent. The differences in roles and responsibilities affect salary ratios within each category as opposed to gender.

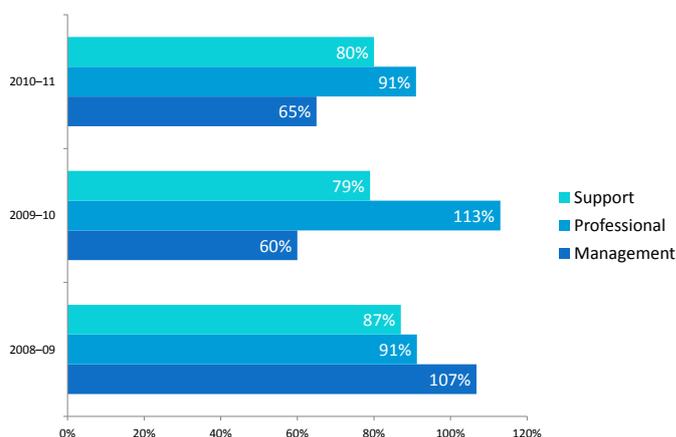


Figure 4: Ratio of female to male basic salaries per hierarchy level

Non-discrimination and indigenous rights

Australian Ethical recognises the Ngunnawal people as the traditional custodians of the Canberra area where our main office and the majority of staff are located.

No incidents of discrimination on the grounds of race, colour, sex, religion, political opinion, national extraction or social origin were reported in 2010–11. Australia Ethical has not recorded any incidents involving indigenous rights in the reporting period related to either employees or to communities near the company's operations.

Staff turnover

At Australian Ethical it is recognised that employees are inherent to our success.

Australian Ethical is committed to providing a safe work environment where employees are provided with development opportunities and encouraged to perform at their best. Regular performance reviews are conducted to ensure that Australian Ethical remunerates appropriately and rewards effort and ability. Work life balance and flexible working practices are encouraged to promote healthy lifestyles and retain valued employees.

Employee turnover figures provide one measure of a company's success in these areas.

For the period 1 July 2010 to 30 June 2011, the annual turnover rate was 12 per cent. This rate is a 36 per cent reduction on the previous financial year (down from 18.8 per cent).

In addition, three (3) employees were made redundant as their positions were no longer required by the Company and no suitable redeployment options were available. This is the same amount of redundancies as in the previous financial year. Employees who were made redundant were provided with access to Outplacement Consultancy services and continued to receive access to the Employee Assistance Program. Redundant employees were paid their full entitlements under established employment contracts and relevant company policy.

Table 5: Voluntary staff turnover by employee type, gender, age group and location¹

Staff turnover ²	Financial year		
	2008–09	2009–10	2010–11
Turnover by employment type			
Full-time employees departing	7	5	5
Part-time employees departing	0	4	1
Part-time employees departing – FTE	0.0	2.4	0.6
Employees departing (total) – FTE	7.0	7.4	5.6
Total staff at 30 June1	50	48	50
Total FTE staff at 30 June1	45.4	45.2	46.6
Staff turnover (% of total staff)	14.0%	18.8%	12.0%
Staff turnover (% of FTE staff)	15.4%	16.4%	12.0%
Turnover by gender			
Staff departing – female	4	5	3
Female staff turnover (% of total staff)	8.0%	10.4%	6.0%
Staff departing – male	3	4	3
Male staff turnover (% of total staff)	6.0%	8.3%	6.0%
Turnover by age group			
Staff departing <30	5	2	3
<30 Age group turnover (% of total staff)	10.0%	4.2%	6.0%
Staff departing 30–50	1	5	2
30–50 Age group turnover (% of total staff)	2.0%	10.4%	4.0%
Staff departing >50	1	2	1
>50 Age group turnover (% of total staff)	2.0%	4.2%	2.0%
Turnover by location			
Canberra office	6	7	5
Other	1	2	1

¹Turnover figures were restated to reflect the number of employees leaving voluntarily, or due to dismissal and retirement. Turnover figures exclude redundancies.

²Figures include permanent and probationary employees but not temporary staff, casual staff or contractors.

Severance pay and job placement services

Australian Ethical does not have a minimum period for notifying employees of operational change. The company does, however, comply with all contractual and legislative requirements in relation to staff entitlements in the event of a position being made redundant.

Training and education

Training and education of Australian Ethical's workforce takes a number of forms including performance appraisals, external training courses, support for additional studies and a personal development program. Regular morning teas also provide a forum for informing employees about environmental and social issues surrounding our activities. Ongoing training and professional development increases employee skills and job satisfaction. Training and education is also important in attracting and retaining talented personnel.

Performance appraisal

All staff at Australian Ethical participate in the annual performance planning and development program.

Australian Ethical's Performance Planning and Development process to assist in achieving our Vision by helping employees and managers to:

- communicate the Company's priorities;
- guide the alignment of goals across the business;
- facilitate the achievement of meaningful objectives and the ongoing feedback needed to improve performance at all levels;
- identify development needs that assist growth in current role; and
- attract, motivate, develop and retain talent.

The Performance Planning and Development process aligns individual performance and development with company goals and objectives. It also allows time for employees and managers to discuss current and future employment and development opportunities. Importantly, Australian Ethical is focussed on providing staff with the opportunity to develop agreed objectives and to take ownership and control in the delivery of these objectives.

This year, a new system for probation reviews was introduced into the organisation. The benefits of this revised process include:

- Each employee receives two structured meetings regarding their performance with their supervisor;
- Awareness of performance or behaviour issues, if any;
- Training and development needs are documented and can be acted on;
- Confirmation of appointment is based on data through a formal process, rather than subjective opinion;
- The employee and manager discuss and agree areas of competence/improvement;
- If out of the performance planning and development cycle, the employee still receives a formal review in their first 6 months.

Training and development

Formalised training of our staff includes structured training provided by Australian Ethical and private study pursued externally. In 2010–11 Australian Ethical employees undertook a total of 2074 hours of training, an increase from 1296 hours in 2009–10. The average number of training hours undertaken by staff during the period also increased from 20 hours per employee in 2009–10 to 35 hours per employee in 2010–11 (Figure 5). Average training hours increased for each of the employee categories. Training hours can exhibit large differences between years, particularly as employees complete their studies or undertake new studies.

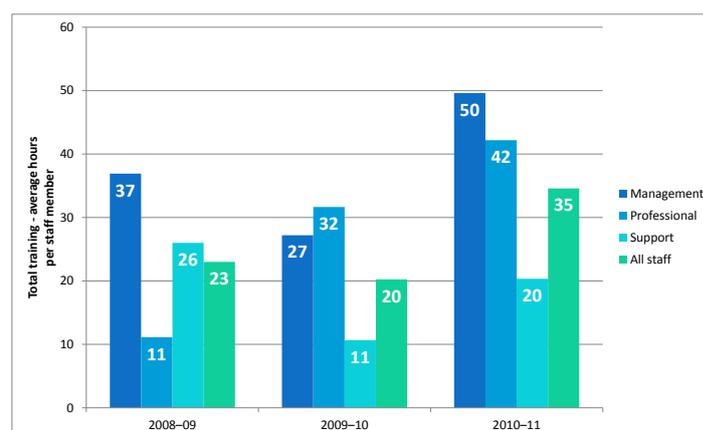


Figure 5: Total average hours of training and study undertaken by staff

Structured training refers to training that Australian Ethical has paid for as work time including paid study leave. Any training that employees are required to undertake during working hours is fully paid and after hours training entitles the employee to time off in lieu. On average, staff undertook 18 hours of structured training during 2010–11, a slight increase from 17 hours in 2009–10. Structured training undertaken by support staff increased from 11 hours to 16 hours between 2009–10 and 2010–11, while structured training undertaken by management staff dropped from 27 hours per employee to 20 hours per employee (Figure 6). Structured training for professional staff remained constant at 19 hours per employee on average.

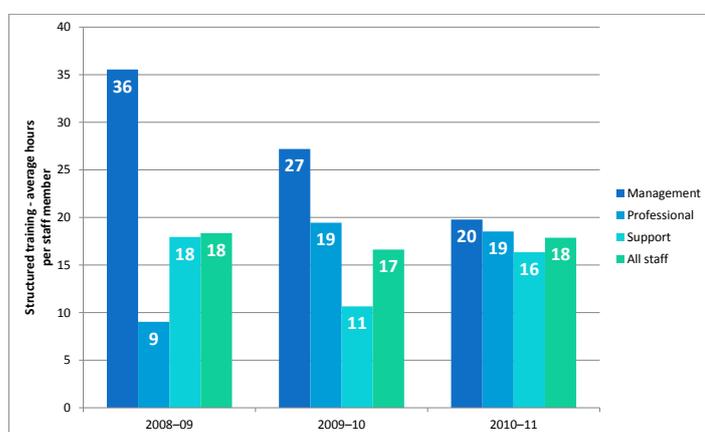


Figure 6: Average hours of structured training undertaken by staff

Employees who are enrolled in private external study or professional development receive financial support and paid study leave. Australian Ethical's reimbursement system refunds 100 per cent of course fees for approved courses, up to \$2000 per year per employee with the completion of the course. Paid study leave is available for three hours per week to attend or travel to classes or to complete course work for approved programs. An additional two full days per year of paid study leave may also be taken for exam preparation or to finalise course requirements.

Figure 7 indicates an increase in external private study undertaken by employees from four hours per employee during 2009–10 to 17 hours during 2010–11. This increase is a result of more employees undertaking tertiary degrees with financial support from Australian Ethical. In 2009–10 no management employees undertook private study, this increased to an average 30 hours per employee in 2010–11. Professional staff's private study also increased from 12 hours in 2009–10 to 24 hours in 2010–11. Private study among support staff picked up slightly, from nil hours in 2009–10 to four hours.

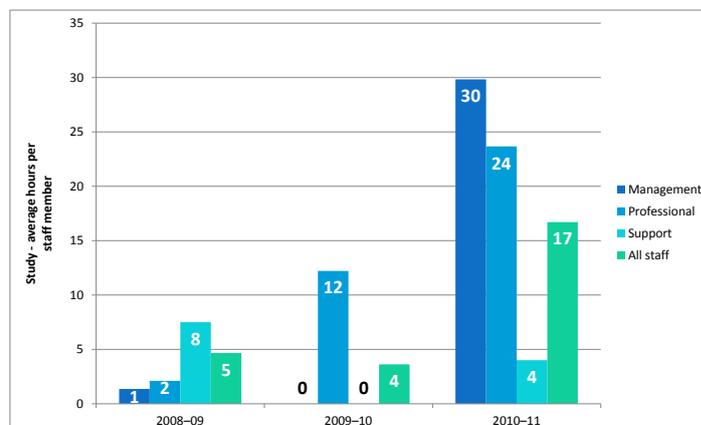


Figure 7: Average hours of study undertaken by staff

Money spent on training increased to \$119,162 in 2010–11, almost \$4,200 more than \$114,964 spent the previous year. The increase was also reflected on a per employee basis, with money spent per employee (excluding casual staff and contractors) rising to \$2,383 in 2010–11 (up from \$2,254 in 2009–10). The increase in expenditure and increase in average hours of training per employee is due to differences in the type of training undertaken, with more money being spent on conferences and short courses in place of external training courses such as tertiary degrees and diplomas.

Skills management and lifelong learning programs

Australian Ethical has a longstanding commitment to support a healthy work-life balance. Our personal development program supports employees participating in a diverse range of activities from indoor cricket and gym membership to dance and music classes. The program entitles all permanent employees to an annual reimbursement of \$190 (pro-rata for part-time staff) to cover such activities.

Employee benefits

Australian Ethical is committed to providing an attractive range of benefits to staff. All benefits offered to permanent full time employees are also made available to permanent part-time employees on a pro-rata basis. Temporary employees have access to all leave accrual entitlements and receive job related training. Casual employees receive long service leave accrual and any job related training they require.

To recognise family and personal responsibilities, Australian Ethical supports flexible working arrangements. These include flexible work hours, a high proportion of part-time employment, work from home arrangements where practicable, a subsidised personal development program, free access to a 24 hour counsellor through the employee assistance program and recent accreditation as a breastfeeding friendly workplace.

In addition, staff receive three days leave for the Christmas closedown period, eligible staff receiving six weeks paid maternity and adoption leave; entitlement to 25 days long service leave after 5 years service along with study and examination leave.

Other staff benefits and activities

Breastfeeding Friendly Workplace Accreditation

This year, Australian Ethical was accredited as a Breastfeeding Friendly Workplace. Our aim was to display leadership by creating a supportive environment for breastfeeding women in the workplace by implementing a breastfeeding policy and providing adequate facilities to support breastfeeding employees. Both the Sydney and Canberra offices gained this accreditation.

Vegetable garden

A 2011 staff initiative was to develop a staff vegetable garden on the front balcony of our Canberra office. The garden has been established for the use of everyone and is already providing a good range of salads, herbs and fruit. Staff have planted tomatoes, capsicum, chilli, parsley, garlic chives, basil, Thai mint, many lettuce varieties, snow peas, sugar snap peas, strawberries and ballerina apple trees. Australian Ethical is even using its own compost in the garden!

Staff BBQ

The Company has purchased a BBQ for staff and it has already been put to great use for a fundraiser day and the National Ride to Work Day. Staff are looking forward to the warmer weather to make more use of their BBQ.

Staff offsite day

This year, all staff were invited to a staff offsite. The day was hugely successful with excellent feedback received including letters of thanks to the Managing Director from some long term employees. The day covered strategic priorities, dealing with any employee concerns, a team building activity, information on the new performance planning and development program and the announcement of our corporate values.

Employee assistance program

In 2011, Australian Ethical has continued to provide access for all staff and their immediate family to an external employee assistance program which provides a professional, confidential and free counselling service.

Employee share ownership plan

Australian Ethical encourages employee equity in the company through the ownership of shares. This is achieved through the opportunity of both short and long term incentive plans.

We aim to build and sustain our workforce with competitive remuneration and a diverse range of benefits. The aim is to attract, retain and motivate the talent pool capable of delivering our business strategy.

All employees participate in general share ownership arrangements. Australian Ethical's remuneration philosophy is designed to drive superior levels of performance based around business strategies, whilst aligning remuneration with the resultant value creation for shareholders.

Healthy workplace

Australian Ethical is acutely aware of its obligations when it comes to workplace health and safety. This year has seen the review and implementation of a suite of occupational health and safety related policies and procedures. These include a return to work policy, an accident, incident and hazard reporting policy and procedure and bullying and harassment policy.

Hazards, incidents and accidents are reported on a register and employees are encouraged to discuss any concerns in relation to health and safety with human resources or their manager.

During 2010–11 there was no time lost to injury at Australian Ethical. However, two (2) injuries were sustained, one outside the workplace but during work time. This is an increase of two (2) injuries on the 2009–10 reporting period. In the same period, no occupational diseases were recorded and there were no work related fatalities. Following on from previous years, Australian Ethical offered flu vaccinations to all staff in 2011, with 10 taking up the offer.

The average number of days taken in sick leave increased in 2010–11 to 5.9 days per staff member (6.3 days per FTE staff member). This is an increase on last year of 1.1 day per staff member; however, being a relatively small company average sick leave days may exhibit large fluctuations year to year.

To maintain an active and healthy lifestyle, Australian Ethical encourages employees to ride their bicycle to work. Facilities at the Canberra office make riding a bike to work an attractive alternative to driving. These include a lockable bike shed, showers, personal lockers, a tyre repair kit and a bike pump. Quarterly, alternative transport days encourage staff to consider different ways of commuting to work including walking, sharing transport, catching a bus or riding their bike. Australian Ethical also participates in the National Ride to Work Day, an annual event promoting the environmental and health benefits of bike riding each spring.

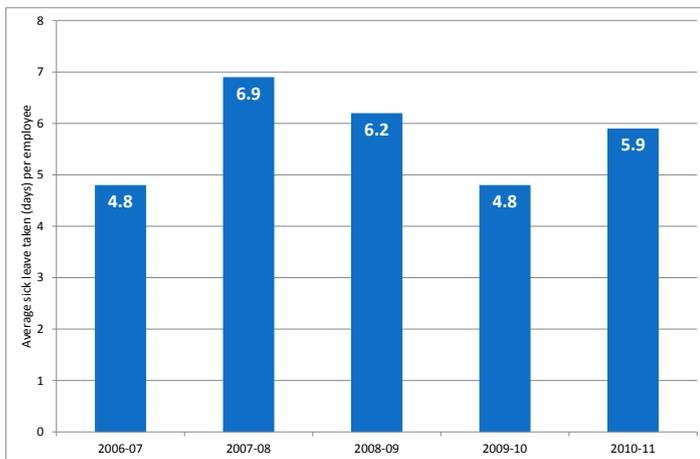


Figure 8: Sick leave taken (days) per staff member

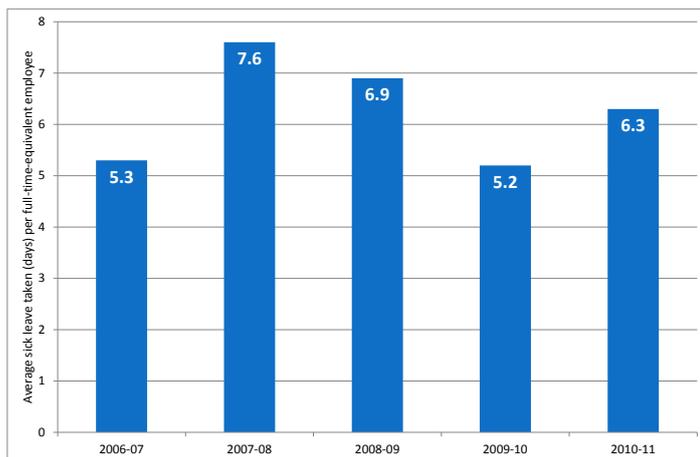


Figure 9: Sick leave taken (days) per FTE staff member

Society

Community

Australian Ethical's constitution states that before a dividend can be declared 10 per cent of profit (after notional tax before staff bonus) has to be donated for charitable, benevolent and conservation purposes. This is part of our contribution to a positive and sustainable society and is one of the highest levels of corporate giving in Australia based on per centage of profits.

In 2011 Australian Ethical donated more than \$150,000 to 22 charities as part of its community grants scheme which brings the total amount gifted to communities over the last 11 years to more than \$1.28 million. This year's grants range in size from \$3600 to \$35,000 and included donations to charities that work across Australia and overseas. The successful organisations were chosen from more than 300 applicants.

Major project grant recipients - \$35,000 each

Carpets for Communities



Carpets for Communities helps families in Poipet, Cambodia out of poverty through the creation of a social enterprise – making carpets for sale commercially. This scheme offers an alternative source of income to Cambodian children working or begging in the local flea markets – activities that can lead to human trafficking, prostitution and other child exploitation.

Their \$35,000 grant will be used to enable ten mothers to join the program. The funds will cover vocational, business and financial literacy training, as well as complementary education and development programs. The funding will assist them to get to a base level of income stability within their family.

By allowing the mothers to start producing carpets within a very short time frame, the scheme provides an immediate intervention solution to allow their children to return to school. Within 48 hours of a mother entering the program, their children can be off the streets and back in school.

Any profits generated in the sales of the goods will go back into bringing more families into the program.

Men of the Trees



Men of the Trees have been working with Western Australian farmers since 1979 to implement large-scale revegetation projects in the wheatbelt. Since that time it has planted more than 11 million seedlings to prevent the spread of deserts, erosion and salinity.

Men of the Trees will use their \$35,000 grant to fund revegetation of a highly degraded landscape in the wheatbelt of Morbinning, east of Perth. The project involves five neighbouring land managers who want to revegetate and protect a creek that runs through their properties. The funding is effectively \$3.50 per seedling that covers one-on-one support to individual farmers, purchasing the seedlings, site preparation, transportation and development of a communication plan.

Men of the Trees is not only a tree planting organisation, but also delivers an environmental and socially responsible program. This involves field officers working with farmers and designing the best natural resource management outcomes, while fitting in with farming practice. Site preparation and back-up maintenance aids the success of revegetation.

Minor grant recipients - up to \$5000 each

ACT Eden Monaro Cancer Support Group

Funds will go towards giving cancer patients and their families assistance in cost of living expenses, putting healthy food on tables as well as fuel in their car so they are able to get to treatment or appointments on a daily basis.

Animal Rescue Queensland

Funds will go towards re-homing dogs who were victims of recent floods, including bringing them back to health through providing veterinary support and supplies.

Arthritis and Osteoporosis Association of Northern Territory

Funds will go towards prepaid satchels for library returns. Members with isolation or mobility issues can borrow and return catalogued library resources free of charge, thus minimising their feelings of isolation.

Australia Zoo Wildlife Warriors

Funds will go towards the free treatment of over 8500 injured or orphaned wildlife each year. Up to 30 different species are admitted to hospital each day.

Australian Afghan Hassanian Youth Association

Funds will go towards a swimming program for Afghan boys and girls, allowing them to participate in school swimming carnivals, connect them to their new homeland and break down social isolation.

Australian Platypus Conservancy

Funds will go towards the delivery of platypus conservation lessons to 20 schools (1000 students) leading to reduction in platypus deaths from illegal fishing, yabbing and litter entanglement in the Yarra River Catchment area.

Barefoot Economy

Funds will go towards steam distillation to convert aromatic plant stock into essential oils for sale internationally, funding for an additional commercial crop and 500 additional jobs for local growers in Chitwan, Nepal.

Bikes for Humanity

Funds will go towards turning a shipping container into a workshop (with necessary equipment), providing skills training, employment and business opportunities to Namibian community. 400 bikes will then be sold at low cost, giving access to employment, education and health care.

Brighter Future 4 Kids Foundation

Funds will go towards providing free leather school shoes and socks to kids with no shoes or worn out shoes. This will ensure children can go to school without the stigma of having no shoes, increasing school attendance, reducing ill health and reducing school bullying.

Children's Hospital Westmead

Funds will go towards classroom for patients, keeping kids up to date with school work, maintaining confidence and self esteem, reducing isolation and loneliness and promoting a sense of normalcy.

Cranbourne Police Senior Citizens Register

Funds will go towards the purchase of personal alarms, shower stools, toilet aids, walkers, frames and sticks to be distributed amongst 350 senior citizen clients. This will help them feel safe in their own homes and also encourage them to get out without fear of falling.

Dhimurru Aboriginal Corporation

Funds will go towards lessening the environmental impact of visitors in general recreation areas by installing a composting toilet at Banambarmga, reducing human waste pollution on sacred sites. Training and empowerment of Yolngu Rangers will also be provided to maintain the site.

Diamond Valley Foodshare

Funds will go towards the purchase of an insulated vehicle to transport donations of food from schools, businesses and various outlets - making up healthy and nutritious food parcels for needy people.

Environment Victoria

Funds will go towards 20 young migrant and refugee kids working together over 6 months to learn about local environments and sustainability. They will achieve a Certificate I in Active Volunteering, deliver community projects and be given employment pathways.

Free the Bears Foundation

Funds will go towards a western trained vet nurse to train local Cambodians in skills needed to maintain this facility – including x-ray, anaesthesia, endoscopy and ultrasound skills. Funds will also be used to supply a reference library of manuals, send two Cambodian vets to look at sanctuary in Vietnam and to build ties and share skills in bear care.

Kokoda Track Foundation

Funds will go towards volunteer labour which will distribute donated school furniture and hospital beds to needy villages in Papua New Guinea, improving quality of life for communities. The community grant will cover shipping costs of these bulky donated items.

Liverpool Plains Land Management

Funds will go towards planting trees to provide more food and shelter for koalas, linking corridors to existing areas away from cleared areas and mitigating twin threats of climate change and habitat loss.

Rainforest Rescue

Funds will go towards restoring vital cassowary habitat and assisting in the recovery of populations impacted by Cyclone Yasi. Birds are vital for seed dispersion of 230 rainforest plants and this will enable Cassowary food species to be planted in wildlife corridors.

Room to Read Australia Foundation

Funds will go towards providing support for Indian girls to complete 10 years of education. This will include school fees, uniforms, textbooks, supplies and transport. Educated women earn more, are healthier, and go on to educate their own children.

Royal Guide Dogs for the Blind Association

Funds will go towards the cost of raising and training guide dogs to provide long term assistance to the blind, increasing mobility, independence, safety and confidence.

Corruption

There is always a risk of fraud and corruption, and this poses significant monetary and reputational risks to Australian Ethical. We endeavour to analyse, minimise and manage these risks through a variety of company policies, systems and procedures. Ongoing compliance and risk management controls are in place through all of Australian Ethical's operations and business units.

An important aspect of internal fraud control is the Australian Ethical code of conduct, which explicitly refers to and prohibits bribery: 'As a general rule, don't accept (or offer to give) gifts, services, discounts, gratuities or other gains from (or to) people who conduct business with Australian Ethical. There are some exceptions – small gifts or invitations to local social or sporting functions are generally acceptable. The offering of bribes to anyone is prohibited outright. Breaking this principle could compromise all concerned and is illegal.'

The Australian Ethical code of conduct explicitly addresses other areas of corruption relevant to the financial sector. These include:

- conflicts of interest
- disclosure of confidential information
- insider trading
- fair competition

The specific instructions on insider trading for all Australian Ethical employees are:

'If you have non-publicly known, price-sensitive information such as: information acquired through working on investments, information about a proposal, information about any other entity in which Australian Ethical may have an interest; or information that has come to your knowledge through your employment with Australian Ethical, then you must not deal in that entity's investments or pass that information on to another person or encourage another person (for example, a family member) to make any investments in the entity.'

There were no recorded incidents of non-compliance with the code of conduct or incidents of corruption in 2010–11.

Public policy

From time to time Australian Ethical will lobby local and state governments on issues relating to ethical investment. Australian Ethical occasionally provides comments to the media on the nature of ethical investment and its related issues. In 2010–11 representatives from Australian Ethical provided comments for various media including the *Sydney Morning Herald*, the *Brisbane Times*, the *Australian Financial Review*, Crikey website and *Business Spectator*.

Political donations

It is Australian Ethical's view that corporate donations to political parties distort the normal democratic process and allow for disproportionate access to and influence of politicians.

Australian Ethical's code of conduct explicitly prohibits unauthorised political donations and states that only the board may make political donations on behalf of the company. Australian Ethical made no political donations during the 2010–11 financial year.

Anti-competitive behaviour

Australian Ethical is bound by its constitution, the Charter and its code of conduct to maintain strict ethical and law abiding standards. While Australian Ethical endeavours to vigorously compete among its peers to achieve its goals, it strives to do this in a fair, just and legal manner. There were no legal actions for anti-competitive behaviour, anti-trust and monopoly practices during the 2010–11 financial year.

Compliance

There were no significant compliance breaches in 2010–11 reportable to either the Australian Securities and Investments Commission or to the Australian Prudential and Regulatory Authority.

Product responsibility

Asset management policy – screened funds

Australian Ethical pursues a unique combination of financial and ethical objectives when selecting investments for its screened funds. These objectives consist of:

- containment of the risk of investing
- obtaining a financial return commensurate with any risk taken
- avoiding investment in activities which are socially or environmentally detrimental
- prioritising investment in profitable activities which bring social or environmental benefits.

One way we achieve these objectives is by ensuring that investments align with the Australian Ethical Charter. Each investment is subject to regular monitoring and reviews to ensure ongoing compliance. The use of the Australian Ethical Charter makes our investment methodology unique in the ethical investment market.

The application of the Australian Ethical Charter defines the universe of investments for the screened funds. As at 30 June 2010 this universe covered a broad spectrum of sectors and countries (Tables 6 and 7).

Table 6: Percentage of investments by sector as at 30 June 2011

Sector	Balanced Trust	Smaller Companies Trust	Larger Companies Trust	International Equities Trust	Property Trust
Energy	1.23	4.51	2.75	0.00	0.00
Materials	1.55	6.02	2.77	1.74	0.00
Industrials	9.61	13.16	18.74	38.47	0.00
Consumer Discretionary	3.54	3.34	6.26	8.48	0.00
Consumer Staples	0.00	0.00	0.00	0.00	0.00
Health Care	6.69	14.28	20.59	0.00	0.00
Information Technology	7.35	16.26	12.14	31.82	0.00
Telecommunication Services	2.02	8.34	4.13	0.00	0.00
Utilities	3.18	5.55	5.80	12.69	0.00
Financials ex Prop Trusts	6.89	20.73	19.53	0.00	0.00
Listed Property Trusts	1.19	0.00	3.83	0.00	0.00
Direct Property	9.89	0.00	0.00	0.00	95.24
Unlisted Equities	0.04	0.48	0.00	0.00	0.00
Cash & Other (incl Fixed Interest)	46.81	7.33	3.46	6.80	4.76
Total	100.00	100.00	100.00	100.00	100.00

Debate is an integral part of the Australian Ethical decision making process – for this reason input is sought from stakeholders. While the company reserves the right to exercise judgment regarding investment selection, comments about the ethical profiles of trust investments are provided regularly to the Board's Investment Committee. The profiles of trust investments are prepared by CAER – Corporate Analysis. Enhanced Responsibility.

In October 2005 Australian Ethical became one of the first fund managers to receive certification under the Responsible Investment Association Australasia (RIAA) certification program. This included verification of Australian Ethical investment selection processes through an independent auditing process managed by the association. Further information can be found at www.responsibleinvestment.org.

Ethical analysis

Australian Ethical is known as a specialist in the field of ethical investment. Ethical investment is an investment process that incorporates environmental and social factors when selecting investments, in addition to the objective of achieving competitive financial returns. Australian Ethical was one of the pioneers of this approach.

Australian Ethical analysts and researchers from CAER investigate the environmental, social and governance (ESG) dimensions of potential investments. This work is supervised by the investment committee through the chief investment officer. Through this process the investment committee keeps abreast of major new scientific initiatives, outcomes and developments. Attendance at conferences and seminars covering environmental and social issues also assist researchers and staff in identifying potential risks and opportunities. This research capacity allows an active approach to seeking out enterprises that contribute to a sustainable future.

Table 7: Per centage of investments by country as at 30 June 2011

Country	Balanced Trust	Smaller Companies Trust	Larger Companies Trust	International Equities Trust	Property Trust
Africa	0.00	0.00	0.00	0.00	0.00
Australia	84.98	90.06	74.73	6.80	100.00
Austria	0.00	0.00	0.00	0.00	0.00
Belgium	0.00	0.00	0.00	0.00	0.00
Canada	0.00	0.00	0.00	0.00	0.00
Denmark	0.38	0.25	0.64	2.36	0.00
Finland	0.00	0.00	0.00	0.00	0.00
France	0.00	0.00	0.00	0.00	0.00
Germany	2.24	1.48	3.77	13.90	0.00
Greece	0.00	0.00	0.00	0.00	0.00
Hong Kong	0.39	0.26	0.65	2.39	0.00
Ireland	0.00	0.00	0.00	0.00	0.00
Italy	0.48	0.32	0.80	2.96	0.00
Japan	1.67	1.11	2.82	10.39	0.00
Middle East	0.00	0.00	0.00	0.00	0.00
Netherlands	0.50	0.33	0.84	3.11	0.00
New Zealand	0.52	0.34	0.87	3.21	0.00
Norway	0.20	0.14	0.34	1.27	0.00
Portugal	0.00	0.00	0.00	0.00	0.00
Singapore	0.32	0.21	0.54	2.01	0.00
Spain	0.06	0.04	0.11	0.39	0.00
Sweden	0.00	0.00	0.00	0.00	0.00
Switzerland	0.00	0.00	0.00	0.00	0.00
United Kingdom	0.60	0.40	1.01	3.73	0.00
USA	7.65	5.07	12.87	47.48	0.00
Other Asia	0.00	0.00	0.00	0.00	0.00
Other Europe	0.00	0.00	0.00	0.00	0.00
Other	0.00	0.00	0.00	0.00	0.00
Total	100.00	100.00	100.00	100.00	100.00

The investment philosophy is based on the principles of the Australian Ethical Charter. The Charter provides guidance in setting out types of activities to be supported, as well as types of activities to be avoided. By utilising the Charter, Australian Ethical applies both a positive and a negative screen to its investments. There are certain types of companies Australian Ethical will not invest in (for example, companies operating in the tobacco, uranium or gambling industries). Conversely, Australian Ethical actively seeks out companies that are involved in positive activities (such as the production of renewable energy). This approach distinguishes Australian Ethical from most other ethical fund managers.

When determining the ethical merits of a company, Australian Ethical considers the core business activity of the company in question. Investment becomes a possibility provided the activity of the company does not directly contravene any principles the Charter requires us to avoid (e.g. companies with human rights concerns; Table 8). Investment is more likely if the core activity of the company meets one of the positive elements of the Charter.

Table 8: Tenets of the Australian Ethical Charter which directly relate to human rights¹

The Trusts shall seek out investments which provide for and support	The Trusts shall avoid any investment which is considered to unnecessarily
(a) the development of workers' participation in the ownership and control of their work organisations and places	(ix) exploit people through the payment of low wages or the provision of poor working conditions
(h) activities which contribute to human happiness, dignity and education	(x) discriminate by way of race, religion or sex in employment, marketing, or advertising practices
	(xi) contribute to the inhibition of human rights generally

¹These tenets also apply to Australian Ethical's own operations including its procurement practices.

Having made a decision on the ethical merits of a company's core activities, it is necessary to determine whether the behaviour of the company in carrying out its core activities is consistent with the Charter. For example, Australian Ethical is more likely to invest in companies with positive workplace relations records or market leading sustainability initiatives. This in depth ethical research is generally carried out by CAER and is gathered from a range of public and non public sources such as company publications, media, government information and material from non government organisations.

Once an investment is deemed acceptable according to the Charter, Australian Ethical's analysts undertake a financial analysis. Once an investment makes it through the investment selection process set out above, it becomes an investment that is subject to regular and ongoing monitoring. All companies within the trusts undergo a regular ethical review and are subject to continual monitoring. All investor queries regarding the ethical performance of investee companies are responded to and a review and summary of enquiries is passed to the investment committee as part of its quarterly meeting process.

If, for example, an investee company diversifies into an excluded industry or engages in unacceptable practices, a review will be performed which may involve company engagement (either correspondence, telephone or face-to-

face). If, on the weight of evidence, the stock or investment is no longer considered appropriate, it will be divested as soon as possible.

In developing the engagement process for a particular investment, Australian Ethical formulates the best approach suited to the issue or the particular situation and documentation of the engagement process is maintained. During the 2010–11 financial year Australian Ethical engaged with 35 companies in which Australian Ethical held an interest. This represented 35 per cent of the total of 101 companies held at the end of the 2011 financial year. Australian Ethical engaged companies on a number of issues, including greenhouse gas emissions, waste and recycling, animal welfare, industrial relations, supply chain and military involvement. Australian Ethical also engaged an additional 13 companies on a range of environmental and social issues in which Australian Ethical did not hold an interest.

Australian Ethical aims to be as transparent as possible about the results of the investment process. For further information in relation to this process, product disclosure statements include details of companies invested in and a regularly updated list of investments also appears on the company website www.australianethical.com.au.

Climate Advocacy Fund

Shareholder activism can be seen as an alternative to, or augmentation of, conventional responsible investment approaches such as screening and ESG integration and even most engagement (in that it is a more visible, transparent and a public manifestation of the latter).

The decision by Australian Ethical to pursue and develop this methodology in a formalised and disciplined approach led to the establishment of the Climate Advocacy Fund.

Australian Ethical had long conceived that approaches other than screening, for which it was a domestic pioneer, or even the positive/thematic emphasis for which it was equally recognised, have merit by enhancing sustainable principles and expanding opportunities. The Climate Advocacy Fund's principal focus is to put resolutions to company AGMs and obtain support from other shareholder, in order to change corporate behaviour around climate change issues. Its emphasis on shareholder activism combined with a fundamental index not based on the market capitalisation of the investee companies makes it unique.

The decision that the newly formed fund should focus on matters of climate change was simply an acknowledgement of the critical magnitude of the issue.¹

¹ As the keynote speaker at the Climate Change Summit, Sydney, 2007, James Thier referred to climate change as 'the biggest issue facing this generation. Some would say it's the most important issue to face all generations. The scope and potential of climate change – environmental, humanitarian, health, political - makes it an overarching issue to rival the consequences of war in magnitude.'

The initial resolutions lodged with companies in the 2010-11 Australian corporate reporting season fell within three broad categories, that they should:

1. describe their carbon emissions footprint
2. have a plan to reduce their overall emissions to a publically stated, target level (or at least to target a reduced level of emissions intensity)
3. ensure investment decisions and balance sheet valuations are based on publically stated, reasonable assumptions about future carbon emission pricing and regulation

Resolutions were lodged for consideration at the AGMs of four companies:

- Aquila Resources and Paladin Energy on point one above
- Oil Search on point two above
- Woodside Petroleum on point three above

The Climate Advocacy Fund's resolution formulation process included input from The Climate Institute.

The process

The first two resolutions were lodged in September 2010 and related to Aquila and Paladin's AGMs held in November 2010. These were standard resolutions requiring 51 per cent of votes cast in order to be successful. Following their own legal advice both companies rejected the resolutions, as not being shareholder business and declined to put them before shareholders for their consideration. This was not unexpected given that resolutions of this nature are relatively unknown in Australia.

Interestingly too, at or after the AGMs were finalised, both companies acceded to the requests made within the resolutions for disclosure of company carbon emissions. Aquila agreed to produce the data within 12 months and Paladin to do so within two years.

In the case of Oil Search, a standard resolution was also lodged for its AGM in May 2011. However, dialogue with the company revealed a willingness to achieve the desired outcome, public targets on emission reductions and the resolution was withdrawn. This resulted in Oil Search management and senior personnel from the Climate Advocacy Fund team identifying timeframes which could achieve public disclosure of a target for greenhouse footprint reduction without a resolution. The proposed Climate Advocacy Fund resolution was withdrawn.

The Woodside resolution was arguably a more legalistic approach. During correspondence it became apparent that Woodside would reject the first proposed resolution as not being shareholder business. The decision was made to lodge a constitutional change resolution. This form demands

a higher hurdle to succeed, 75 per cent voter agreement, but it is also obligatory for it to be placed before shareholders.

In parallel, more comprehensive contact was made with a range of institutional investors and domestic superannuation funds providing them with background material and rationale. All of these were either CDP participants or signatories to PRI. Contact was also made with industry bodies and proxy advisers. At the AGM vote on 20 April a total of 5.69 per cent of shareholder's supported the resolution. In US terms this would be a very creditable first time result; likely leading to a repeat of the resolution in a subsequent year.

Judging success

Whilst it is appropriate to judge the performance of the Climate Advocacy Fund's approach with regard to achieving company action on climate change via resolution 'wins', it is also clear that success is not limited to attaining a majority of votes at an AGM, as the above examples highlight.

Positive outcomes will also be attained where the company decides to make improvements or where a 'negotiated settlement' removes the need for a resolution to be put. In addition the publicity associated with the process of resolution formulation raises awareness of the topic and educates investors and other stakeholders and potentially contributes to change in corporate attitudes and behaviour.

Proxy voting policy

Australian Ethical's policy is to vote (or make a considered decision to abstain) on investee company resolutions where it has voting authority and responsibility to do so (consistent with IFSA Standard 13.00 – Proxy Voting). Australian Ethical's aim is to vote all proxies for Australian and international investee companies. Decisions on how to vote proxies will be made on a company-by-company and resolution-by-resolution basis with regard to the following factors:

- the preservation and increase of the value of the investment in the best interests of members in the managed investment schemes
- improving and upholding the governance of investee companies
- the performance of the investee company
- the application of the Australian Ethical Charter to the resolution under consideration

For the period 1 July 2010 to 30 June 2011 a total of 728 resolutions were received across the Balanced Trust, Smaller Companies Trust, Larger Companies Share Trust and International Equities Trust (no shares are held by the Income Trust or Property Trust, which precludes these trusts from the proxy voting process). It should be noted that:

- holdings in some companies were sold prior to an annual general meeting being held
- annual general meetings were held prior to the company having holdings in some companies
- some resolutions were voted on at extraordinary or special general meetings for specific issues

Of the 728 resolutions voted on across the four trusts, 657 were voted 'for', 16 were voted 'against', we 'abstained' from voting on 16, 15 were 'vote for pay frequency' and 24 were 'non-voting resolutions'.

Negative votes

The negative votes related to:

- insufficient detail being provided
- appointment of directors (reasons included lack of experience and being responsible for poor performance of a company)
- remuneration issues (including director fees and CEO severance payments)
- resolutions that may not be in the best interest of shareholders (including misuse of shareholder funds).

Abstained votes

The resolutions we abstained from voting on related to:

- insufficient detail being provided
- being unable to access an English explanation of source documents, for example, explanatory memorandums
- local issues difficult for analysts to vote on.

Vote for pay frequency resolutions

Many US companies have included a resolution with regard to 'say on pay frequency' this past 12 months (voting for 1, 2 or 3 year frequency).

Non-voting resolutions

The non-voting resolutions related to financial statements.

Product disclosure statements

Under the Corporations Act 2001 a retail investor must receive a product disclosure statement before acquiring

a financial product. A product disclosure statement is a document that sets out the key features of the financial product being offered and should disclose any risks, benefits and cost involved with the financial offering. It is Australian Ethical's policy to complete and distribute a product disclosure statement as required by law and in accordance with company compliance procedures. Product disclosure statements are made freely available both in print and electronic form upon request and on the Australian Ethical website.

Company procedure includes the review of product disclosure statements by appropriate section heads within Australian Ethical through verification and sign off. Product disclosure statements are reviewed by Australian Ethical's legal team and board delegates who are delegated the responsibility for overseeing the review of the document.

In addition to this, tenet 'b' of the Australian Ethical Charter states that the company should seek out and support production of high quality and properly presented products and services. Adherence to this tenet is required internally by Australian Ethical as well, as it is enshrined in the company constitution. Hence the same standard applies to the company's internal operations as the Charter requires of investee companies. In short 100 per cent of the company's products and services are subject to these information requirements.

In 2010–11 there were no incidents of non-compliance with regulations and voluntary codes concerning products and service labelling, including publication of product disclosure statements.

Customer satisfaction

Australian Ethical values its customers and their experiences when interacting with customer service representatives, and as such, Australian Ethical regularly monitors customer satisfaction and complaints to ascertain specific areas of operational concern and potential improvement.

Australian Ethical recorded 53 complaints and general expressions of dissatisfaction from investors and superannuation members in 2010–11. Most of these complaints were considered minor; no complaints were considered major. This result was slightly disappointing compared to 2009–10, where 30 customer complaints and general expressions of dissatisfaction were recorded.

Marketing communications

Marketing activities are carried out within the broader context of the Australian Ethical business plan and the overall strategy of the marketing section. These activities are governed by the marketing section procedures manual and the Australian Ethical constitution. Laws, standards,

voluntary codes, regulatory agencies and associations that have particular relevance to Australian Ethical's marketing activities include the Corporations Act 2001; Goods and Services Tax; National Privacy Principles; Copyright; Spam Act 2003; Trade Practices Act 1974, Australian Securities and Investments Commission (ASIC); Investment and Financial Services Association Limited; Association of Superannuation Funds of Australia Limited; and the Advertising Standards Council.

Customer privacy

Australian Ethical takes its responsibility to maintain the privacy of its customer's details and information extremely seriously and confirms that there were no complaints from customers regarding breaches of privacy or losses of data during the 2010–11 financial year.

Environment

Australian Ethical seeks to ameliorate wasteful or polluting practices in its own operations and in its investments. Environmental impacts of office-based businesses include consumption of paper and stationery, energy and water use, transport, waste and greenhouse gas emissions.

Reducing resource consumption

Australian Ethical is committed to reducing its resource consumption; a commitment supported by the company's purchasing policy:

- Australian Ethical will consider ethical issues in deciding what to buy;
- Australian Ethical will follow the 4 R's – reduce, reuse, recycle and refuse – in considering whether to make purchases;
- In general, Australian Ethical is prepared to pay up to a 20 per cent premium for a more sustainable product and will consider a higher premium for an exemplary product;
- Australian Ethical will consider alternatives to travel, especially air travel before business travel is undertaken (e.g. phone and video conferences).

Eco-efficient practices

Australian Ethical has implemented a number of eco-efficient practices throughout its business operations including:

- Double-sided printing as default option on all computers
- use of Evolve 100 per cent post-consumer recycled printer and photocopy paper (www.evolve-papers.com)
- paper reuse trays at desks
- paper and cardboard recycling facilities
- purchasing office stationery made from recycled materials where possible
- recycling of printer toner cartridges
- printing of Aim High newsletter, product disclosure statements and annual reports on 100 per cent recycled, calcium carbonate coated chlorine-free paper using vegetable-based inks
- use of paper pens for outreach made using 100 per cent recycled paper tubes
- electronic copies of the product disclosure statements available on the Australian Ethical website (www.australianethical.com.au)
- recycling facility in kitchen for glass, plastic and aluminium
- compost bin in kitchen for organic matter and organic matter compost facility outside

- the purchase of Green Power electricity and the offsetting of travel related greenhouse gas emissions via Climate Friendly (www.climatefriendly.com)
- donating old computers to Charity Computers and staff for reuse.

Materials

Paper

Communicating with current and potential investors is an essential part of a fund managers' business. Paper currently plays an important role in facilitating this communication. A key challenge for the company is reducing paper usage while communicating with a greater number of investors and superannuation members.

During 2010–11 Australian Ethical used approximately 1.195 million A4 sheets of 100 per cent recycled paper (equivalent

Table 9: Paper usage¹

Paper usage	Financial year		
	2008–09	2009–10	2010–11
A4 sheets			
Managed investments PDS	46,397	123,963	77,494
Superannuation PDS	99,099	160,203	83,472
Climate Advocacy Fund PDS	0	72,222	93,886
Newsletters	344,967	264,976	346,000
Leaflets	146,775	191,400	78,000
Annual report to shareholders	3,600	3,000	0
Trust annual report	57,567	49,567	18,000
Printer and photocopier paper	254,331	281,772	301,980
Letterhead paper	49,250	14,563	18,438
Compliment slips (A4 equivalent)	900	1,292	333
Super fund statements (mail house)	49,656	90,883	85,271
Super annual report	35,598	38,253	42,000
Other	18,984	24,622	50,472
Total A4 sheets	1,107,124	1,316,716	1,195,345

¹Paper usage data excludes envelopes.

to 96 trees of non-recycled paper; Table 9). Newsletters represented 29 per cent (346,000 A4 sheets) of the paper used; office printing and photocopying paper, 25 per cent (301,980 A4 sheets); product disclosure statements (PDS), 21 per cent (254,852 A4 sheets); and leaflets, 7 per cent (78,000 A4 sheets; Table 9). Paper use in 2010–11 decreased by 121,370 A4 sheets or 9 per cent over the previous year. The largest decreases occurred in leaflets (down 113,400 A4 sheets), and PDS' (down 101,536 A4 sheets). This was partially offset by an increase in newsletters (up 81,024 A4 sheets).

Printer and photocopier paper usage per average full-time equivalent staff member (Canberra office) decreased by 1 per cent per cent in 2010–11 to 7,221 A4 sheets (or approximately 14.5 reams; Figure 10). While this compares favourably with the 20 reams per FTE found in a benchmarking study of 34 organisations by the Commissioner for Environmental Sustainability (2007), the 1 per cent decrease is disappointing and failed to meet our 10 per cent reduction target for 2010–11. Australian Ethical is determined to reduce its printer and photocopier paper use and has again set a 10 per cent reduction target for the current year. Staff education is a key part of the reduction strategy.

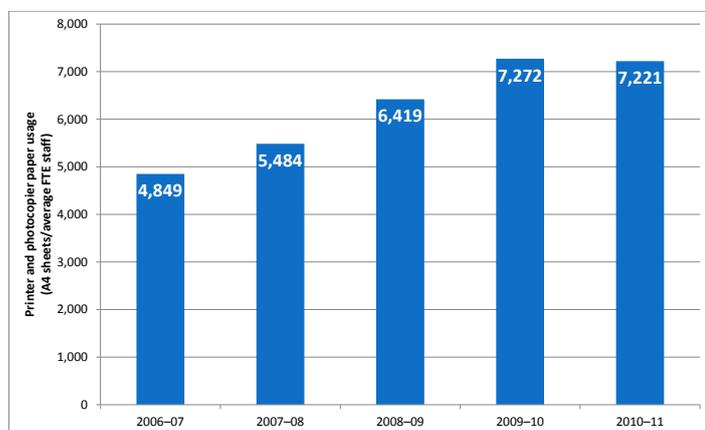


Figure 10: Printer and photocopier paper usage per average full-time equivalent staff member

Technology will help Australian Ethical restrict its paper usage by reducing the need for information to be sent on paper. For example, potential investors can access our product disclosure statements via the Australian Ethical website and much of the information previously mailed to investors is now sent by email. As technology improves, Australian Ethical aims to provide more information to its stakeholders by electronic means, restricting and reducing paper use.

In February 2011, Australian Ethical launched its online application forms for individuals to join our ethical super fund and for employers making contributions for their staff. Individuals can join in four simple steps and employers can join in two. No printing is required and applicants will

receive an electronic copy of their application. To join online go to australianethical.com.au/join-now-individuals for individuals or australianethical.com.au/join-now-employers for employees.

Australian Ethical also launched a mobile version of our website that can be browsed from a number of mobile devices, including smartphones and standard devices.

Stationery

Australian Ethical's stationery use as represented by total dollar costs, decreased by \$170 or 3.2 per cent in 2010–11. The cost per average full-time equivalent staff member decreased to \$123 (Table 10) and underscores the company's commitment to its 4 R's Policy – reduce, reuse, recycle and refuse.

Table 10: Stationery use

Stationery costs	Financial year		
	2008-09	2009-10	2010-11
Total cost	\$5,014	\$5,317	\$5,147
Cost/average FTE staff based in Canberra	\$127	\$137	\$123

Energy

In Australia, the commercial building sector is responsible for 10 per cent of total greenhouse gas emissions (DCCEE, 2011). The built environment is an area which presents significant opportunities for carbon abatement and mitigation of climate change.

The 2010–11 year was Australian Ethical's fourth full financial year in the six green star Trevor Pearcey House. During 2010–11 Australian Ethical used 486,891 MJ or 534MJ/sqm of energy (80,666kWh of electricity and 196,493 MJ of gas). On a per square metre basis, this represents a 9 per cent increase on our 2009–10 energy use (Table 11; Figure 11).

Electricity use per square metre increased by one per cent over the year, from 87 kWh/sqm in 2009–10 to 88 kWh/sqm in 2010–11 (Table 11; Figure 12). Gas use per square metre also increased over the period, rising 20 per cent from 179 MJ/sqm in 2009–10 to 215 MJ/sqm in 2010–11 (Table 11; Figure 13).

The increase in electricity use during 2010–11 is very small. The rise in gas usage was associated with changes to the programming of the heating system to assist with staff comfort and also a problem with the building management system scheduler, which was fixed in May 2011. We will be aiming to reduce the gas usage going forward. We are currently investigating other possible causes of the increase in electricity and gas usage.

Table 11: Energy use

Energy use	Financial year		
	2008-09	2009-10	2010-11
Energy MJ ¹	367,745	447,827	486,891
Energy MJ/sqm	403	491	534
Electricity kWh	74,393	79,071	80,666
Electricity kWh/sqm	82	87	88
Gas MJ	99,929	163,172	196,493
Gas MJ/sqm	110	179	215
GHG emissions (tonnes CO ₂ e)	86.37	95.66	99.62
GHG emissions (tonnes CO ₂ e/sqm)	0.095	0.105	0.109

¹ Sum of total gas and electricity usage, where 1 kWh = 3.6 MJ.

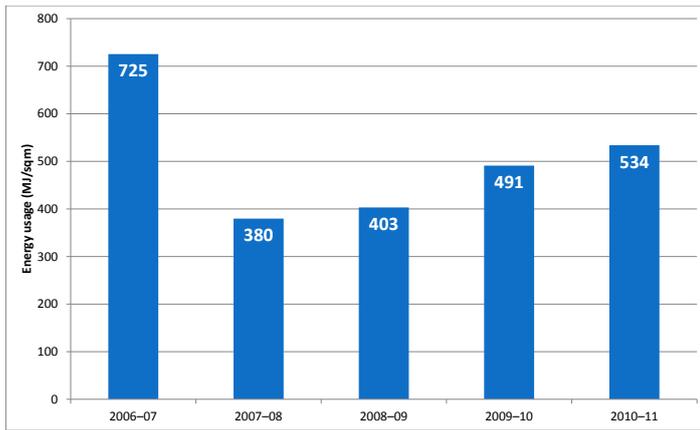


Figure 11: Energy usage (mega joules per square metre)

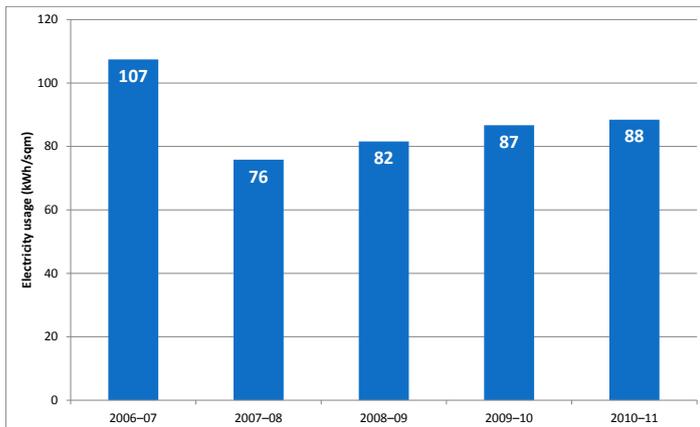


Figure 12: Electricity usage (kilowatt-hours per square metre)

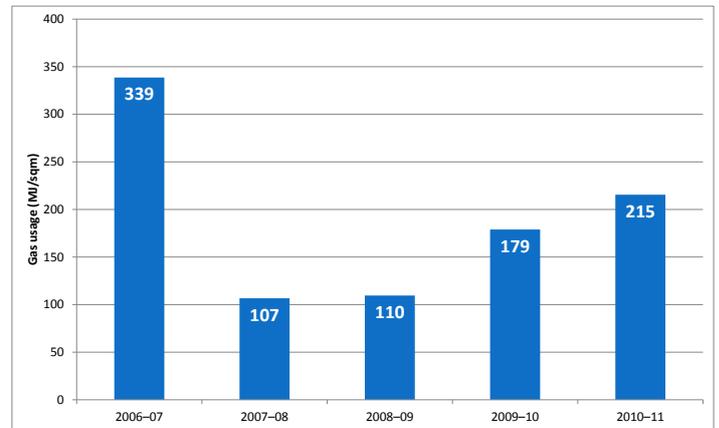


Figure 13: Gas usage (mega joules per square metre)

In order to negate the greenhouse gas emissions related to our energy use, Australian Ethical purchased 100 per cent accredited Green Power from ActewAGL along with carbon credits from Climate Friendly (www.climatefriendly.com). By doing this, we saved and offset 99.62 tonnes of CO₂e (or 0.109 tonnes CO₂e/sqm) that our energy use at Trevor Pearcey House would have generated (Table 11; Figure 14). The per square metre figure of 0.109 tonnes CO₂e/sqm is 65 per cent lower than the greenhouse gas emissions from an average Canberra office building.

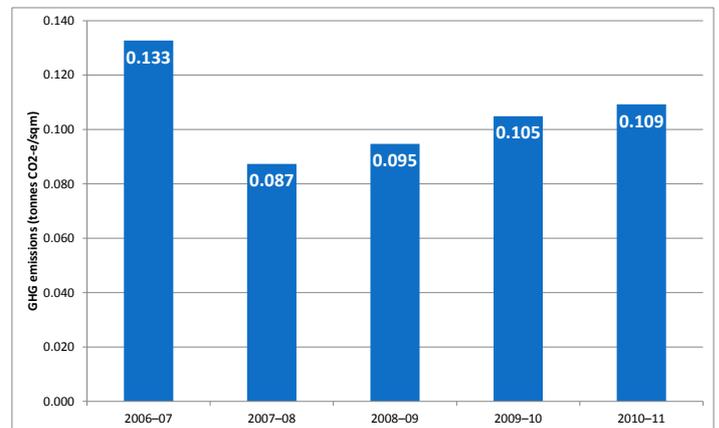


Figure 14: Greenhouse gas emissions (tonnes CO₂e/sqm)

The performance of Australian Ethical's Trevor Pearcey House highlights the benefits that can be achieved by refurbishing an existing office block according to green building design principles. There is a growing supply of underused or aged buildings that are in need of maintenance or upgrading. It is estimated that in developed nations about a third of building construction activity can be attributed to renovation or retrofitting. Such renovation projects offer a high-yield investment potential, along with low-risk eco-retrofitting opportunities for building owners and tenants (Birkeland, 2008). Since Australian Ethical refurbished Trevor Pearcey House to a six green star level it has conducted regular tours through the offices to those interested in pursuing similar projects.

The refurbishment was undertaken using a conventional budget, using accepted low-technology design principles. These included:

- passive cooling and ventilation combined with a wider thermal comfort band reducing demand on mechanical systems
- double glazed windows
- 'reverse brick veneer' external walls – this ensures the thermal mass on the inside is insulated from the outside air temperature
- R6 insulation under the metal deck roof
- improvements to shading panels
- exposing the ground floor slab
- evacuated tube solar hot water heating
- highly efficient T5 artificial lighting
- timer and occupancy controlled lighting
- workspaces designed to take maximum advantage of natural light

The building is designed to be passively cooled in the warmer months by a 'night purge'. This involves the windows automatically opening at night when the temperature drops to draw cool air into the building, while the hot air from inside the building is exhausted via the four internal stacks and the louvered windows in the barrel vault.

Further information on the Trevor Pearcey House refurbishment can be found on Australian Ethical's website australianethical.com.au.

Water

Water scarcity is a key issue facing Australia today. Australian Ethical is committed to the careful use of this precious resource. Water efficient features incorporated into Trevor Pearcey House include:

- taps upgraded to 4L per minute, showerheads to 5A fittings - 6L per minute
- upgrade of the existing single flush toilets to dual flush with a 9/4.5L system.
- urinals upgraded with a Sani-Sleeve low water use system reducing water use by 95 per cent
- rainwater tanks collecting from the roof and plumbed for use in flushing the toilets
- garden drip irrigation with moisture sensor
- Water Guard leak detection

During 2010–11 Australian Ethical used 88 kL of mains water. This represents just 0.10kL/sqm which is 86 per cent less than the median Canberra office water consumption benchmark of 0.72 kL/sqm². As a result of a broken data connection to its water meter system in July 2009, Australian Ethical was unable to report its water use data for 2009–10 (Table 12; Figure 15).

² Calculated benchmark based on a median Canberra office water consumption of 0.72 kL/net lettable area (NLA) sqm (Department of the Environment and Heritage 2006)



Table 12: Water usage

Water used	Financial year		
	2008–09	2009–10	2010–11
kL/sqm	0.09	Not available	0.10
Total kL	81	Not available	88

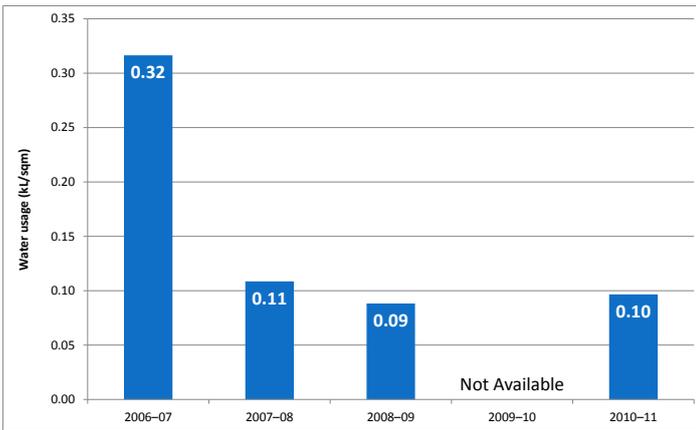


Figure 15: Water usage (kilolitres per square metre)

Transport

During 2010–11, 50 per cent of employees commuted to work by car on their own – slightly less than the previous year (53 per cent). Another 15 per cent of employees carpooled, a small increase compared to 2009–10 (11 per cent). The use of motor vehicles to get to work is significantly lower than the overall average for the ACT, where approximately 83 per cent of people drive to work (ACT Integrated Transport Framework, 2008).

Overall the proportion of the workforce which commutes to work in a car in 2010–11 has remained relatively unchanged compared to 2009–10; however we have seen changes from single occupant cars to multiple occupants, and a slight increase of employees using buses to get to work. A full breakdown of Australian Ethical’s employee’s modes of transport for 2010–11 is shown in Figure 16.

Australian Ethical is aware that the use of motor vehicles in the daily commute to and from work is responsible for significant greenhouse gas emissions. To encourage the use of alternative modes of transport with a smaller environmental footprint, Australian Ethical promotes the use of bicycles by providing free secure bike storage facilities and shower amenities. Additionally, the head office is located on several bus routes which makes the use of public transport practical.

Flights are the largest source of emissions at Australian Ethical. In 2010–11 Australian Ethical staff made 472 flights and 655 taxi cab trips (2009–10: 596 flights and 716 taxi cab trips). Total greenhouse gas emissions from air travel in 2010–11 was 103.7 tonnes, compared to 111.9 tonnes

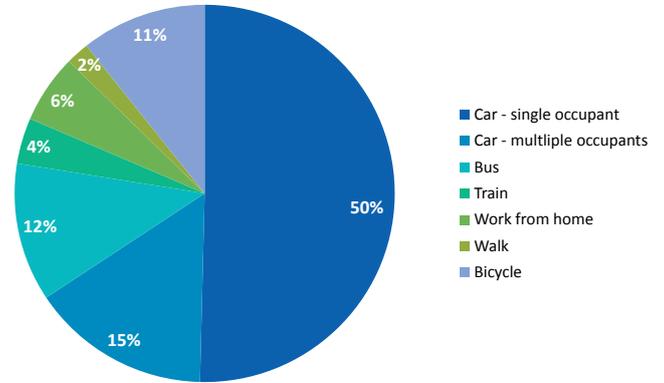


Figure 16: Primary transport used by Australian Ethical staff to commute to work during 2010–11.

in 2009–10. Greenhouse gas emissions per average FTE decreased, from 2.33 tonnes in 2009–10 to 2.12 tonnes in 2010–11 (Figure 17). Australian Ethical offset all emissions from flights and cab trips using Climate Friendly (www.climatefriendly.com).

To encourage and promote the use of alternative forms of transport as a way of reducing the environmental impact of commuting, Australian Ethical hosts alternative transport days, which include a free breakfast for employees who made use of an alternative mode of transport to get to work, such as walking, riding or public transport. Australian Ethical makes available corporate bus tickets to employees who need to travel during work hours for work purposes within Canberra. Additionally, Australian Ethical endeavours to use its teleconferencing facilities where possible to replace face-to-face meetings that may require travel. Where business travel cannot be avoided, Australian Ethical encourages employees to choose the most sustainable travel option.

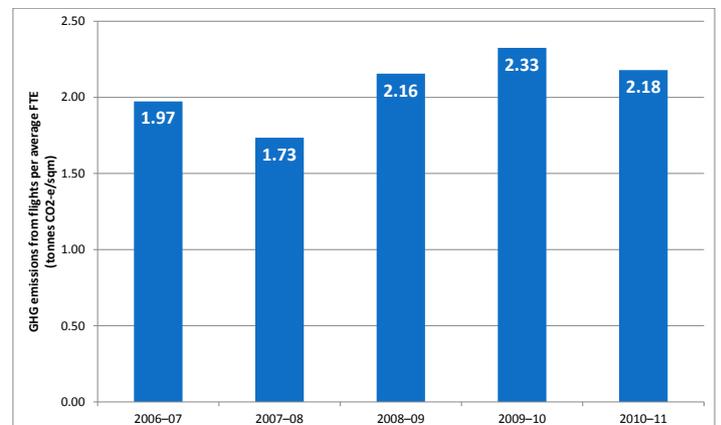


Figure 17: Greenhouse gas emissions from flights (tonnes CO2e) per average FTE

Emissions, effluent and waste

Waste

According to the United Nations Environment Programme – Sustainable Buildings and Climate Initiative the built environment is responsible for approximately 30–40 per cent of solid waste generation (UNEP–SBCI, 2009). It is estimated that Australian Ethical produced 4086 kg of waste in 2010–11, a decrease from 4422 kg of waste generated in 2009–10. Approximately 3678 kg of waste generated was recycled, which is about 90 per cent of the total waste generated, while 408 kg of waste went to landfill. The majority of waste was paper, making up approximately 74 per cent of total waste. The category of waste to landfill recording a decrease in 2010–11 was general waste, which reduced by 136 kg. Other categories increased (Tables 13 and 14).

Table 13: Waste for the year to 30 June 2011

Waste type	Weekly waste (kg)	2010–11 waste (kg)	% of waste sub-total	% of total waste
Waste to landfill				
Paper	1.1	57	14%	1%
Cardboard	0.9	47	11%	1%
Recyclable containers ¹	1.4	73	18%	2%
Food organics	1.2	62	15%	2%
General waste ²	3.3	169	41%	4%
Sub-total	7.9	408	100%	10%
Waste recycled				
Paper	58.2	3,027	82%	74%
Cardboard	1.3	69	2%	2%
Recyclable containers ¹	1.8	94	3%	2%
Food organics	9.4	489	13%	12%
Sub-total	70.7	3,678	100%	90%
Waste generation total³	78.6	4,086		100%

¹ Includes glass, plastic and aluminium.

² Includes plastic wrappers/bags, tissues, paper hand towels etc.

³ Australian Ethical's Canberra offices only.

Table 14: Waste for the year to 30 June 2010

Waste type	Weekly waste (kg)	2009–10 waste (kg)	% of waste sub-total	% of total waste
Waste to landfill				
Paper	0.1	5	1%	0%
Cardboard	0.2	12	3%	0%
Recyclable containers ¹	0.6	30	7%	1%
Food organics	0.4	20	5%	1%
General waste ²	7.0	364	84%	8%
Sub-total	8.3	431	100%	10%
Waste recycled				
Paper	58.6	3,052	76%	69%
Cardboard	2.3	122	3%	3%
Recyclable containers ¹	3.5	180	5%	4%
Food organics	12.3	637	16%	14%
Sub-total	76.7	3,991	100%	90%
Waste generation total³	85.0	4,422		100%

Waste to landfill per average FTE staff decreased by 1.3 kg in 2010–11 to 9.8 kg (Figure 19). The reduction reflects the decrease in total waste to landfill while FTE figures remained relatively stable.

Greenhouse gas emissions

Australians are now considered to be the world's worst greenhouse gas polluters, emitting 20.58 tonnes of carbon dioxide per person (citizens of the USA emit 19.78 tonnes per person; Maplecroft 2009). Australian Ethical is committed to combating climate change not only through our investments, but also within our own operations. During 2010–11 Australian Ethical saved the equivalent of 94.49 tonnes of carbon dioxide from entering the atmosphere and offset a further 120.07 tonnes (Table 15). Australian Ethical saved 86.31 tonnes of carbon dioxide by purchasing 80,666 kWh of 100 per cent accredited Green Power electricity from ActewAGL under the GreenChoice program. The company also saved a further 8.18 tonnes of carbon dioxide by recycling 90 per cent (3,678 tonnes) of waste. The company offset 120.07 tonnes of carbon dioxide (from natural gas, waste to landfill, flights and taxi cab trips) through the purchase of carbon credits from Climate Friendly (www.climatefriendly.com).

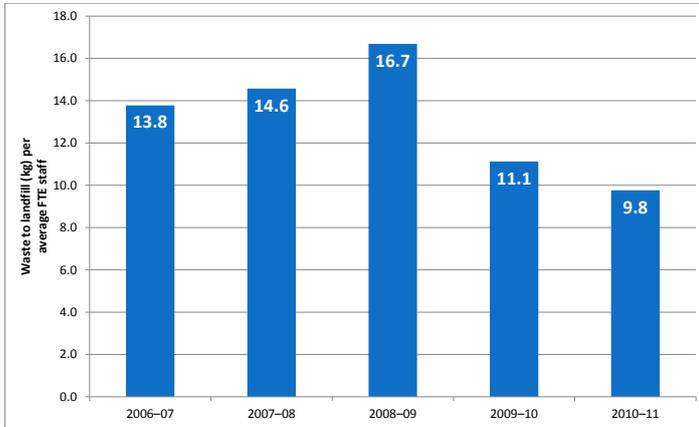


Figure 18: Waste to landfill (kg) per average FTE staff

Prior to being offset, Australian Ethical's 2010–11 greenhouse gas emissions were 5 per cent lower than in 2009–10 (Tables 15 and 16). The decrease in emissions was a result of a decrease in the number of air flights, from 596 in 2009–10 to 472 in 2010–11 offset by an increase in gas usage (increased from 179 MJ/sqm in 2009–10 to 215 MJ/sqm in 2010–11).

Table 15: Greenhouse gas (GHG) emissions for the year to 30 June 2011¹

GHG emissions (t CO ₂ e)	Saved	Generated	Offset
Scope 1 emissions			
Gas	0.00	12.88	12.88
Scope 2 emissions			
Electricity	86.31	0.00	0.00
Scope 3 emissions			
Waste recycled	8.18	0.00	0.00
Waste to landfill	0.00	0.49	0.49
Air flights	0.00	103.70	103.70
Taxi cabs	0.00	3.00	3.00
Total	94.49	120.07	120.07

¹ Greenhouse gas emissions from electricity, gas and waste were calculated using the National Greenhouse Accounts (NGA) Factors – July 2010. Emissions from air flights and taxi cabs were calculated using Climate Friendly's online calculator (www.climatefriendly.com). Scope 1 emissions are considered direct emissions; Scope 2 and 3 emissions are considered indirect. Indirect emissions from courier services have not been calculated.

Table 16: Greenhouse gas (GHG) emissions for the year to 30 June 2010¹

GHG emissions (t CO ₂ e)	Saved	Generated	Offset
Scope 1 emissions			
Gas	0.00	11.05	11.05
Scope 2 emissions			
Electricity	84.61	0.00	0.00
Scope 3 emissions			
Waste recycled	8.50	0.00	0.00
Waste to landfill	0.00	0.43	0.43
Air flights	0.00	111.90	111.90
Taxi cabs	0.00	3.20	3.20
Total	93.11	126.58	126.58

¹ Greenhouse gas emissions from electricity, gas and waste were calculated using the National Greenhouse Accounts (NGA) Factors – June 2009. Emissions from air flights and taxi cabs were calculated using Climate Friendly's online calculator (www.climatefriendly.com). Scope 1 emissions are considered direct emissions; Scope 2 and 3 emissions are considered indirect. Indirect emissions from courier services have not been calculated.

Compliance

Australian Ethical was not subject to any significant fines or non-monetary sanctions for non-compliance with environmental laws and regulations in 2010–11.

Environmental protection expenditure

During 2010–11 Australian Ethical spent a total of \$8,392 on the protection of the environment. This figure includes costs for off setting greenhouse gas emissions through Climate Friendly and paying a premium for Green Power generated from renewable energy sources.

Products and services

The environmental impact of Australian Ethical's products, being financial services, primarily lies with the impact of the companies in which Australian Ethical holds a financial interest. These impacts, while outside the boundary of this report, are ameliorated to a certain extent by Australian Ethical's ethical investment approach.

Economic performance

The following section of the report outlines the company's economic performance during the period 1 July 2010 through to 30 June 2011.

The consolidated entity, Australian Ethical and its wholly owned subsidiary, Australian Ethical Superannuation Pty Ltd, has recorded a consolidated net profit after income tax expense for the year ending 30 June 2011 of \$1,282,533, a 25 per cent increase on the result of the previous financial year.

Return on equity for the year is 17.1 per cent, up from 12.5 per cent in 2009-10. Earnings per share has increased 25 per cent to 128.8 cents per share and the cost to income ratio has reduced slightly to 87 per cent.

Despite the uncertainty in investment markets and the changing regulatory environment, we remain positive and optimistic for the future for Australian Ethical. We have responded to this new environment with some internal restructurings and have maintained good profitability through this period of change.

We continue to be well positioned within the ethical investment market and, with an increased awareness of issues such as climate change, there is a growing recognition amongst investors of the need to invest and save in a more ethically positive way.

Continued investment in, and improvement to our products, sales, marketing and client service should see us strengthen that position.

Average funds under management (FUM) grew by 5.5 per cent with the year end FUM (before distribution) being \$644 million compared to \$614 million for the prior year end (Figure 19). The aggregate distribution amount for the 2010 year was \$13 million. For 2011 this figure was significantly higher at \$25 million.

Funds under management across the investment trusts and corresponding superannuation strategies are all shown in Figures 20, 21 and 22. The company intends to act as a leader, influencing change and advocating for change in the Australian and international business environments in which it continues to invest.

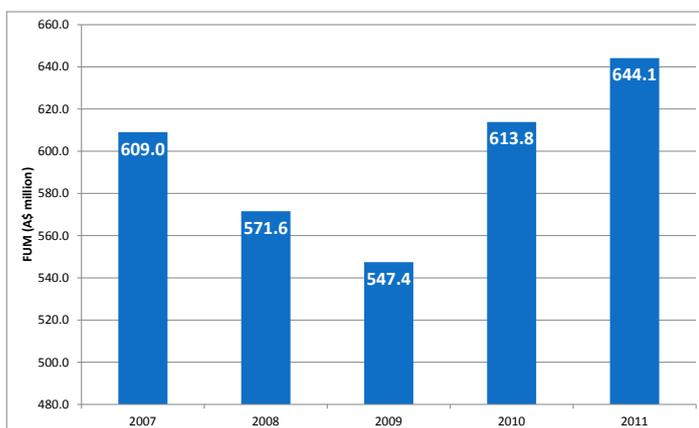


Figure 19: Growth of group funds under management (years ending 30 June) – figures are net of crossholdings

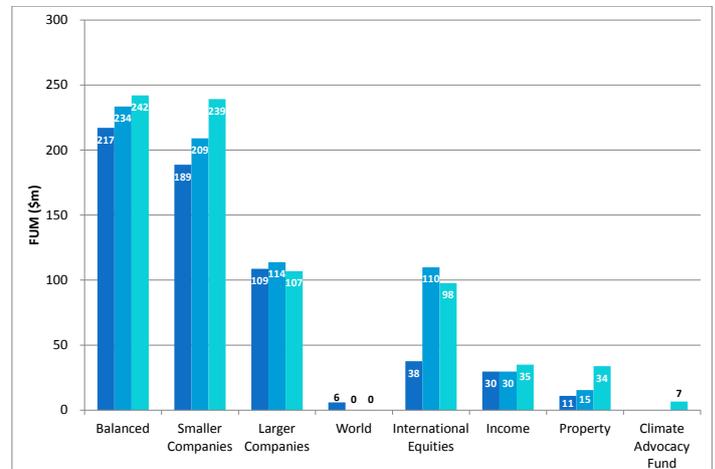


Figure 20: Unit trusts – funds under management – figures include crossholdings

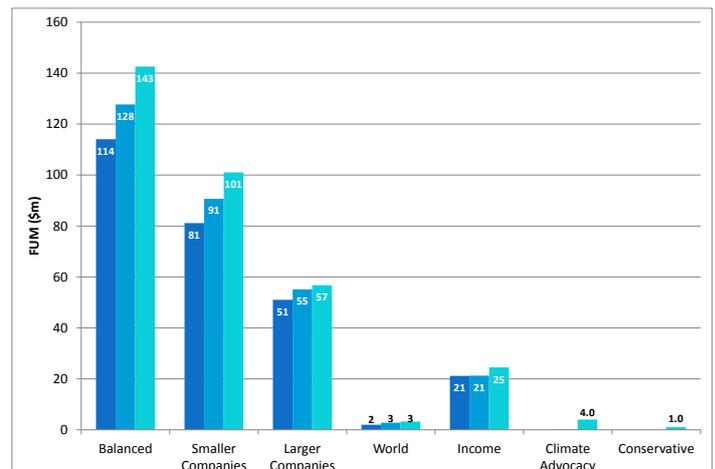


Figure 21: Superannuation accumulation and rollover strategies – funds under management

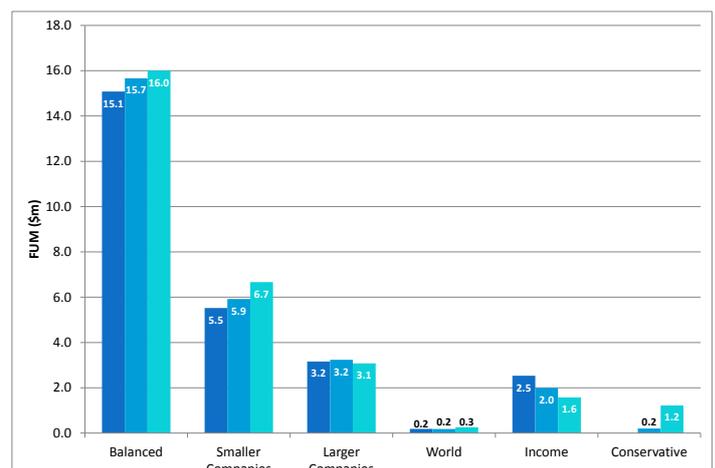


Figure 22: Superannuation pension strategies – funds under management

Revenue to the end of June 2011 was \$15,143,951 up 7.6 per cent, compared with the year ending 30 June 2010, which was \$14,067,899. The company net profit after tax was up 25 per cent to \$1,282,533; the previous profit after tax was \$1,022,555. Total dividend declared in relation to the 2010–11 year was \$1.70 representing a 132 per cent payout ratio. The dividends paid to shareholders during the 2010–11 year totalled \$1,938,772 million. (The payment represents an interim dividend of 45 cents per share and a final dividend of 100 cents per share. The Board agreed that a special dividend be paid of 25 cents per share for the financial year ending 30 June 2011.

Economic value retained went from negative \$782,869 in 2009–10 to negative \$656,239 in the 2010–11 financial year (Table 17). The economic value retained by the company is the difference between the economic value generated (i.e. the profit or loss) and the economic value distributed (i.e. the dividend paid to shareholders), as defined by the G3 framework. Economic value retained was negative again in 2010–11 mainly due to timing issues related to when economic value is generated and when economic value is distributed by the company.

Our inflows have remained resilient in a tough managed funds market and grown by 2 per cent for the year ended 30 June 2011. Inflow growth has been centred around our superannuation fund. Inflow growth has been offset by a reduction in our entry fee margin as we adjust our business model to accommodate regulatory change (entry fee changes to our superannuation fund, implemented in May 2010).

Over the year the company's net assets decreased from \$8,055,728 to \$7,628,812, this is a reduction of \$426,916 in the value of net assets, or a drop in value of 5.6 per cent of net company assets (Table 18).

Table 17: Economic performance indicators – financial year

Economic performance indicator	Financial year		
	2008–09	2009–10	2010–11
Direct economic value generated			
Revenues	\$13,131,431	\$14,067,899	\$15,143,951
Economic value distributed			
Operating costs	\$4,756,294	\$4,997,729	\$5,572,759
Employee wages and benefits ¹	\$6,105,701	\$7,000,615	\$7,147,797
Payments to capital providers (dividend)	\$1,330,329	\$1,805,424	\$1,938,772
Economic value retained			
Payroll tax	\$305,625	\$339,109	\$323,218
Income tax	\$620,191	\$582,950	\$664,842
Total tax (total payment to government)	\$925,816	\$922,059	\$988,060
Community grants	\$140,868	\$124,941	\$152,802
Economic value retained			
Economic value generated less economic value distributed	(\$127,577)	(\$782,869)	(\$656,239)

¹ Excludes payroll tax.

Table 18: Economic performance indicators – balance date

Economic performance indicator	Balance as at 30 June		
	2009	2010	2011
Total assets	\$11,054,919	\$11,099,926	\$11,284,140
Net assets	\$8,453,205	\$8,055,728	\$7,628,812

Australian Ethical community grants

As prescribed in Australian Ethical's constitution, 10 per cent of profit (after notional tax before staff bonus) is donated to charitable, benevolent and conservation purposes as part of the company's contribution to a positive and sustainable society. In 2010 Australian Ethical's community grants program donated \$124,941 to 22 social and conservation projects. In 2011 the community grants pool was increased to \$152,802 and awarded to 22 charitable and conservation organisations. The 2011 community grants included two special project grants of \$35,000 each awarded to Carpets for Community and Men of the Trees.

Financial implications of climate change

Climate change and related issues have significant prominence at Australian Ethical both in our investment management strategies and business operations. Australian Ethical is very much aware of climate change issues in its day to day operations. Climate change has risks and opportunities for all businesses regardless of the sector in which they operate.

Australian Ethical's quite unique position in this niche market in the funds management industry offers investors the opportunity to contribute to solving and alleviating some of the very large environmental and social issues that are faced in Australia, indeed, in the world today.

With continued debate on climate change issues at the political and corporate level, as well as within the media, Australian Ethical expects that awareness of environmental problems will increase year on a year and that this will broaden the number of potential investors. Investors and superannuation members will be more conscious of the benefits of responsible investment in the longer term, particularly in relation to climate change.

Australian Ethical is committed to addressing climate change issues. Since launching the Climate Advocacy Fund in February 2010, Australian Ethical has worked to tackle the climate change challenge from two angles. Our long standing ethically screened investment trusts continue to promote sustainable businesses which in the most part contribute to the effort of reducing the risk of dangerous climate change; and the newer Climate Advocacy Fund provides the opportunity to advocate on the issue of climate change with companies that we would not normally deal with.

The risk of being exposed to companies largely affected by climate change related regulatory changes, such as carbon trading, is considered to be low for the company, given Australian Ethical's investment approach and screening process. The company, due to the way it utilises the

Australian Ethical Charter, selects and screens its potential investments, and hence has minimal exposure to carbon intensive industries within its screened investment portfolio. Australian Ethical considers itself to be well positioned for a market place that ultimately sees an effective price put on carbon.

The Climate Advocacy Fund will be more exposed to the risks of climate change, however the advocacy work integral to this fund is aimed at reducing the climate change risk of the companies that the fund is invested in.

Australian Ethical operations are office based in Canberra and Sydney. The company does not expect any operations to be directly affected by climate change in the near future. However, climate change impacts will make the need for responsible investment more pressing in the investment market place and such interest will only prove to be positive for Australian Ethical.

While the company is aware of the risks and opportunities climate change presents, the company has not quantified the financial implications of climate change for the organisation at this point in time.

Superannuation obligations

The retirement plans offered to all employees of the company are accumulation superannuation strategies based on the requirements outlined by government legislation. There are no defined retirement benefit plans offered to employees.

The company is fulfilling its superannuation obligations as required by Australian law which, broadly speaking, requires that employers contribute nine per cent of salary to a superannuation fund on behalf of employees.

Financial assistance from the government

There are no direct financial benefits gained from the Australian Government to Australian Ethical and further there are no governments represented in Australian Ethical's shareholding. However, changes in government legislation pertaining to superannuation requirements could impact favourably on the funds management industry per se. For example, legislation requiring an increase in superannuation guarantee contributions would have a positive impact on the overall investment funds flowing into the superannuation strategies offered by the company. The impact from legislative changes would also obviously depend on the nature of the change and Australian Ethical's market share at the time that any government legislation is implemented.

Market presence

Suppliers

Tenet 'b' of the Australian Ethical Charter supports the production of high quality products and tenet 'c' supports the development of locally based ventures. These principles are adhered to in the day to day purchasing and sourcing of goods.

Australian Ethical's head office in Canberra, Australian Capital Territory is considered the company's location of significant operation. Being office based and a relatively small organisation with just over 50 employees, the company purchases a moderate amount of stationery, cleaning, staff amenities and corporate office supplies.

The company continues to adhere to the principles in the Charter in day to day operations and consistent with this, Australian Ethical sources significant amounts of business supplies locally, generating and supporting business in the local ACT region. The company has three main suppliers who have offices close to Australian Ethical's operations in Canberra and are the businesses of choice for these purchases. Australian Ethical meets two to three times a year with its major suppliers.

In addition Australian Ethical's purchasing policy allows paying up to 20 per cent more for environmentally or socially exemplary goods and, where possible, these are also sourced locally. For example the company's financial and human resources management software is developed in Australia, sourced from an Australian company with local offices in the ACT. A further example is the fact that the company sources some fair trade coffee and organic teas locally.

Hiring

Australian Ethical's recruitment strategy is aimed at attracting high quality candidates with the skills and experience to ensure the company's ongoing success.

With offices in both Sydney and Canberra there is a focus on recruiting locally for each site by using local media and employment agencies along with internet/web options. Senior management in both Sydney (3) and Canberra (4) were all local hires.

All applicants are required to undergo formal interviews, reference checks and police checks, with successful applicants completing induction and compliance training on entry to the company.

Australian Ethical employees are required to familiarise themselves with and adhere to the Code of Conduct and Charter and internal policies and procedures – all of which are available on the intranet. From time to time presentations are provided to staff to train them on environmental,

social and governance issues. For example in 2010–11 a representative from the Australia Institute presented on the ongoing debate about the Federal Government's carbon tax and emissions trading plans. We also had a presentation on plans to put 50 electric cars on the roads in Canberra supported by a network of recharging points from the First50 Project (www.cleandriving.com.au).

Indirect economic impacts

Indirect economic impacts are of significant importance to Australian Ethical as indirect impacts play an important role in fostering socio-economic change in society.

Australian Ethical's indirect impacts are largely characterised through raising awareness about responsible investment and related issues, such as considering climate change in investment decisions. The company board and various committees need to consider the risks and opportunities that are presented by climate change and this is done via careful consideration of the principles set out in the Australian Ethical Charter in the investment process. Australian Ethical undertakes public seminars and presentations on ethical investment and engages with various media outlets highlighting links between responsible investment or on topical environmental and social issues of interest to Australian Ethical stakeholders and stakeholders at large in the Australian community. Such initiatives provide public benefit to the community through commercial, in-kind and pro bono engagement.

Australian Ethical continued to be a major sponsor and supporter of environmental and social justice events and organisations across Australia in 2010–11, including Sustainable House Day and the Walk Against Warming. Australian Ethical also become a major sponsor of the Australian Youth Climate Coalition. These events and organisations play a high profile role in educating people about the actions they can take to reduce their environmental impacts, and place pressure on business and governments to improve their environmental performance.

Australian Ethical was also the major sponsor of large state based environmental and cultural events such as the Western Australian Conservation Week, the Melbourne Writers Festival, the Green Heart Fair in Brisbane, and the Big Canberra Bike Ride. The company was also a key supporter of other events including Earth Unplugged – Toowoomba, Money & Power Conference, Fair@Square Festival, ACFID national conference and the Sustainable Living Festival.

Australian Ethical, through its investment approach, has an indirect economic impact via the promotion of ESG factors in the wider economy. While the extent of impact is difficult to measure, the adoption of ESG factors by a growing number of mainstream institutional investors in Australia is significant and central to Australian Ethical's vision of future investing.

Assurance

Report content

In defining the report content, Australian Ethical applied the GRI reporting framework's 'Guidance on defining report content' and associated principles. This involved:

- identifying the topics and indicators considered relevant by undergoing an iterative process using the principles of materiality, stakeholder inclusiveness, sustainability context and completeness
- considering the relevance of all indicator aspects identified in the GRI guidelines and financial services sector supplements
- using the tests listed for each principle to assess which topics and indicators were material
- using the principles to prioritise selected topics and decide which were to be emphasised.

Materiality

GRI defines materiality as the threshold at which an issue or indicator becomes sufficiently important that it should be reported (GRI 2008). It refers not only to those topics and indicators that have a significant financial impact on the company, but also includes those economic, environmental and social impacts that cross a threshold in affecting the ability to meet the needs of the present without compromising the needs of future generations (GRI 2008, WCED 1987).

In determining which topics and indicators were material, Australian Ethical took into account a number of internal and external factors. These included Australian Ethical's vision and mission statement, the Australian Ethical Charter (see page 9), the expectations and interests of stakeholders, and Australian Ethical's sustainability impacts, risks and opportunities.

Australian Ethical considered the majority of GRI core indicators to be material. A number of GRI additional indicators were also considered material, as were the majority of indicators contained in the Financial Services Sector Supplement. Topics and indicators were prioritised based on the significance of their economic, environmental and social impact and their influence on the assessments and decisions of stakeholders.

Stakeholder inclusiveness

Australian Ethical uses the Australian Ethical Charter as the starting point for identifying stakeholders. To identify key stakeholders we went through a stakeholder mapping process identifying a broad list of stakeholders who may be impacted by our operations. This list was then narrowed down to a list of key stakeholders based upon the objectives of the Charter and the values and goals set out in the company's corporate vision and mission statements.

Assurance

Independent external assurance enhances the quality and credibility of a sustainability report. Australian Ethical's policy and practice, since its second sustainability report published in 2003, has been to seek independent external assurance of its sustainability report.

Material information within Australian Ethical's 2011 sustainability report was verified by Net Balance. A statement resulting from this verification was provided and is presented on the following page.

INDEPENDENT VERIFICATION STATEMENT

To the Board of Directors and Management of Australian Ethical:

Australian Ethical Investment Limited (Australian Ethical) commissioned the Net Balance Foundation Ltd (Net Balance) to provide independent verification of material data and statements in their 2011 Sustainability Report (the 'Report').

The Report presents Australian Ethical's sustainability performance over the period 1 July 2010 to 30 June 2011. Australian Ethical was responsible for the preparation of the Report and this statement represents the verification provider's independent opinion. Net Balance's responsibility in performing its verification activities is to the management of Australian Ethical alone and in accordance with the terms of reference agreed with them. Other stakeholders should perform their own due diligence before taking any action as a result of this statement.

Verification Objectives

The objective of the verification process was to provide Australian Ethical and its stakeholders with an independent opinion on the accuracy of the information presented within the Report. This was confirmed through verification of material data and statements, review of underlying systems, processes and competencies that support the selected information in the Report.

Verification Process and Limitations

The verification process was undertaken in November 2011, and involved the following:

- Review of selected material data and statements in the report for any significant anomalies, particularly in relation to significant claims as well as trends in data;
- Review of the accuracy and source of selected statements made in the report through examination of 52 selected data points and statements relating to the selected performance topics;
- A series of interviews with key personnel responsible for collating and writing various parts of the report in order to substantiate the veracity of selected claims.

The verification process was subject to the following limitations:

- The scope of work did not involve verification of financial data, other than that relating to environmental, social or broader economic performance;
- Only the corporate office in Canberra was visited as part of this verification engagement.

Our Independence

Net Balance was not responsible for preparation of any part of the Report. Net Balance has not undertaken any other project work for Australian Ethical in the reporting period. As such the verification team was deemed independent and objective.

Our Competency

The verification engagement was carried out by an experienced team of professionals headed by a Lead Sustainability Assurance Practitioner (Lead CSAP), accredited by AccountAbility UK. Our project team has been formally trained in the use of AccountAbility's AA1000 assurance standard and the ISO 14064 greenhouse gas

accounting standard. The engagement included team members with expertise in environmental, social and economic performance measurement.

Our Opinion

Based on the scope of the verification process, the following observations were made:

- The level of data accuracy was found to be acceptable;
- Data trails were easily identifiable and traceable;
- The personnel responsible were able to reliably demonstrate the origin(s) and interpretation of data;
- All suggested changes were satisfactorily addressed by Australian Ethical prior to finalising the report.

The Way Forward

It was found that Australian Ethical has established internal processes in place to manage sustainability performance data. To ensure that Australian Ethical continues to improve, Net Balance has provided recommendations on data collection, management and calculation processes. These recommendations have been provided to Australian Ethical's management in a detailed report.

On behalf of the verification team

15 November 2011

Melbourne, Australia



Terence Jeyaretnam, FIEAust
Director, Net Balance & Lead CSAP (AccountAbility UK)

Glossary

Abbreviation	Expanded name	Definition
FTE	full-time equivalent	Term used to express full-time and part-time staff on an equivalent full-time basis.
GRI	Global Reporting Initiative	This promotes international harmonisation in the reporting of relevant and credible corporate environmental, social and economic performance information to enhance responsible decision-making.
J	Joule	Unit of energy.
kl	Kilolitre	1000 litres.
KWh	Kilowatt-hour	Measure of electrical energy equivalent to a power consumption of 1000 watts (1000 joules/second) for one hour. Note: 1 kWh = 3.6 MJ.
MJ	Mega joule	1,000,000 joules.
W	Watt	Unit of power, equivalent to one joule per second.

GRI Application Table

Report Application Level		C	C+	B	B+	A	A+
Standard Disclosures	G3 Profile Disclosures OUTPUT	Report on: 1.1 2.1 - 2.10 3.1 - 3.8, 3.10 - 3.12 4.1 - 4.4, 4.14 - 4.15	Report Externally Assured	Report on all criteria listed for Level C plus: 1.2 3.9, 3.13 4.5 - 4.13, 4.16 - 4.17	Report Externally Assured	Same as requirement for Level B	Report Externally Assured
	G3 Management Approach Disclosures OUTPUT	Not Required		Management Approach Disclosures for each Indicator Category		Management Approach Disclosures for each Indicator Category	
	G3 Performance Indicators & Sector Supplement Performance Indicators OUTPUT	Report on a minimum of 10 Performance Indicators, including at least one from each of: Economic, Social and Environmental.		Report on a minimum of 20 Performance Indicators, at least one from each of Economic, Environmental, Human rights, Labor, Society, Product Reponsibility.		Report on each core G3 and Sector Supplement* Indicator with due regard to the Materiality Principle by either: a) reporting on the Indicator or b) explaining the reason for its omission.	

*Sector supplement in final version



Statement GRI Application Level Check

GRI hereby states that **Australian Ethical Investment Ltd** has presented its report "Sustainability report 2010/2011" to GRI's Report Services which have concluded that the report fulfills the requirement of Application Level A+.

GRI Application Levels communicate the extent to which the content of the G3 Guidelines has been used in the submitted sustainability reporting. The Check confirms that the required set and number of disclosures for that Application Level have been addressed in the reporting and that the GRI Content Index demonstrates a valid representation of the required disclosures, as described in the GRI G3 Guidelines.

Application Levels do not provide an opinion on the sustainability performance of the reporter nor the quality of the information in the report.

Amsterdam, 16 November 2011

A handwritten signature in blue ink, appearing to read "Nelmara Arbex", is written over a large, faint watermark of the GRI globe logo.

Nelmara Arbex
Deputy Chief Executive
Global Reporting Initiative



The "+" has been added to this Application Level because Australian Ethical Investment Ltd has submitted (part of) this report for external assurance. GRI accepts the reporter's own criteria for choosing the relevant assurance provider.

The Global Reporting Initiative (GRI) is a network-based organization that has pioneered the development of the world's most widely used sustainability reporting framework and is committed to its continuous improvement and application worldwide. The GRI Guidelines set out the principles and indicators that organizations can use to measure and report their economic, environmental, and social performance. www.globalreporting.org

Disclaimer: Where the relevant sustainability reporting includes external links, including to audio visual material, this statement only concerns material submitted to GRI at the time of the Check on 10 November 2011. GRI explicitly excludes the statement being applied to any later changes to such material.

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