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Sustainability Reporting Briefing: Part 1 - Best practice - Reporting gains ground and credibility

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While most agree that sustainability reporting is a good idea, there is debate over the degree of mandatory disclosure

The rationale for sustainability reporting is now well understood. While traditional corporate reports provide details of the financial soundness of a company, the sustainability report sets out its operational soundness: how efficiently it uses resources and how it is protecting itself against operational risks, such as potentially stricter environmental regulation.

The sustainability report should also show that the company is not fundamentally undermining itself, that it is not destroying the natural assets that it ultimately needs for growth.

By providing this information to investors, the sustainability report is a crucial complement to the financial report. It is surprising therefore that relatively few companies publish sustainability reports.

According to figures from CorporateRegister.com, which tracks and assesses corporate responsibility reports, about 6,000 sustainability reports were published in 2011. But this is a small proportion of the estimated 45,000 corporations globally that are required to publish their accounts, and an even smaller proportion of the 80,000 companies large enough to conduct cross-border business. Geographically, sustainability reporting is strong in Europe, but less prevalent in North and South America and in Asia.

For many corporations, a resistance to anything seen as mandatory remains ingrained, even if they accept the principle of sustainability. Alexandre Affre, senior adviser for environmental affairs at the Brussels-based BusinessEurope federation, says: “Although there is an increasing industry awareness and a growing trend towards a more stringent reporting, the regulatory framework should remain flexible and initiatives voluntary."

He adds: "Too-rigid reporting norms and the associated administrative burden could make the framework counterproductive. There are serious doubts about how a one-size-fits-all approach can work. In terms of CO_2 emissions, water consumption, recycling capacities or land use, for example, finding environmental parameters that make sense for reporting is difficult, given the diversity of players."

Resistance is likely to be futile, however. Numerous initiatives around the world seek to embed sustainability reporting, and to force companies to comply if necessary.

Government demands

The UK government's decision to require companies listed on the London Stock Exchange to report on their carbon emissions from 2013 is one example of the global trend. Tom Beagent, assistant director for sustainability and climate change at consultants PricewaterhouseCoopers, says the UK government "believes that when you start to report, you will start to measure and manage emissions". Mandatory disclosure is thus one way of getting companies to contribute to the government's emissions reduction targets.

The British announcement of mandatory emissions reporting was made to coincide with June's Rio+20 sustainability summit. The Central Bank of Brazil used the occasion to start a similar initiative. It published proposals that will affect about 2,000 financial institutions under its authority. Brazil's banks and financing companies will be required to establish sustainability policies, and to produce independently certified annual sustainability reports, the Central Bank says. The measure should be finalised by the end of 2012.

Before Rio+20, there was a campaign by groups such as the Corporate Sustainability Reporting Coalition, convened by insurance giant Aviva, for governments to oblige their companies to publish sustainability reports. This was unsuccessful. The Rio+20 conclusions did, however, include a paragraph "encouraging" the take-up of sustainability reporting.

In reference to this, Brazil, Denmark, France and South Africa have formed a Friends of Paragraph 47 group. The group plans an international "roadmap" on sustainability reporting, which will be prepared with the support of the Global Reporting Initiative (GRI) and the United Nations Environment Programme. France already has some of the world's toughest sustainability disclosure requirements, while South Africa's Johannesburg Stock Exchange has a "comply-or-explain" rule on integrated reporting.

These top-down initiatives come in addition to established codes and programmes, such as the GRI and the Carbon Disclosure Project. Whether companies like it or not, sustainability reporting is here to stay.

Beagent says Rio+20 provided "a direction of travel" on sustainability reporting. "There is a lot of change going on at the moment. The plethora of initiatives and organisations reinforces the need for change. It's important for businesses to view [sustainability] reporting as value-creating."

Just do it – but how?

The different initiatives show that although the "why" of sustainability disclosure is now widely accepted, the "how" is still evolving. Sustainability reports range from broad declarations of good intentions, to lists of targets, most of which seem to be achieved ahead of schedule. Marks & Spencer's Plan A, for example, covers 180 commitments with a 2015 deadline. The company has already met 138 of the pledges.

Richard Ellis, group director of CSR for Alliance Boots, says the evolution in sustainability reporting is not surprising. "We've only really been doing this for about 10 years. We're still in our infancy. For businesses that haven't engaged with this agenda, there is a lot happening." Ellis points out that financial reporting has evolved over a much longer timespan, with global accountancy body the Association of Chartered Certified Accountants tracing its roots back to 1904.

What accountants have done for financial reporting, initiatives such as the GRI seek to do for sustainability reporting. GRI guidelines set out disclosures that companies could make, indicators they could use, and tips for compiling and presenting them. Possible indicators of sustainability range from energy used and conserved, to fines incurred for environmental violations, and expenditure on environmental protection.

The latest version of the GRI guidelines, known as G4, has been published in draft format for consultation (until September 2012). Nelmara Arbex, GRI deputy chief executive, says that as well as generally improving the guidelines, the objective of G4 is to "support companies that are not yet reporting to start reporting".

The current G4 draft, known as the exposure draft, is a "midway document", Arbex says. It is "like a big block of marble waiting for the sculptors around the world". Its post-consultation development will be shaped by working groups and a technical committee that includes accountants, companies, non-profits and trade unions. The committee's main objective is to ensure that the various changes proposed by the working groups are coherent.

The working groups cover supply chain disclosure; disclosure on management approach; governance and remuneration; the scope of a sustainability report such as how far it should go in covering suppliers; the extent of disclosure – GRI has three "application levels" that indicate how far companies have gone in applying the guidelines; anti-corruption; and greenhouse gas emissions.

The final outcome "will be clearer for sure," says Arbex. It will deal with elements in the current guidelines that leave "too much space for interpretation". It should be easier for businesses to identify the topics that are relevant to them – materiality in GRI jargon – and will make the link between a company's financial and sustainability performances "very obvious". The final version of G4 is planned for publication in 2013.

Risk of complexity

The way the G4 revision is structured, and the reams of documentation that go with it (the G4 exposure draft is 325 pages long) make the exercise look complex. The changes being introduced also seem wide-ranging. Adrian Penfold, head of corporate responsibility for real estate investor British Land, professes to being "concerned" about the revision.

British Land currently reports at the GRI B+ application level – in other words, it is considered an "intermediate" sustainability reporter. Penfold says the company analysed going to A+ but this was "all a bit of a waste of time" because the application levels will be revised in G4. "We put a lot of work into it and it can be frustrating if things change," he says.

PwC's Tom Beagent says companies should not be dazzled by the G4 headlights. "It is often overlooked that GRI is a framework to cover many different industries, not a tick-box exercise," he says. Using GRI for sustainability reporting "shouldn't be seen as a daunting task but as a help".

The issue of course is materiality. Companies can pick and choose what is relevant for them from GRI guidelines rather than slavishly follow them. "They will be judged on whether they have picked and chosen right," says Beagent.

Penfold says British Land is reviewing its sustainability reporting to understand better the audience and deliver the relevant information. "We've got the figures, but what do they tell you?" he says.

Initiative overlap

What could complicate things is how GRI G4 overlaps or interacts with the various government initiatives that have sprung from Rio+20 or are a reaction to the crisis of confidence in corporations caused by the economic and financial crisis.

Nelmara Arbex says the G4 revision will allow GRI to align with other reporting trends, such as the push for integrated reporting represented by the International Integrated Reporting Council. But when governments step in there might be overlap or contradictory requirements.

"When government comes to the game it means society has reached a certain level of agreement," Arbex says. "The problem starts when governments start developing their own metrics. You can have hundreds of metrics for the same thing [such as environmental performance or promotion of human rights]".

Arbex adds: "Government wants to understand the long-term performance of their companies, as a basis for regulation, so metrics and comparability are important." But companies could face compliance difficulties in terms of tailoring their reports to different audiences "if we don't have a common language".

Alliance Boots's Richard Ellis expresses the same concern. The risk is that "different parts of government will want different things for different purposes," obliging companies to deliver data even in areas that are not especially relevant for them, such as water strategies for office-based businesses with limited water use.

And the evolution will continue. The eventual "promised land" is arguably an integrated report combining financial and operational sustainability data that will give a true view of a company's worth to investors and society as a whole.

Arbex says an evolution to more standardised single reports will take 10 to 15 years. But, cautions Tom Beagent, "one size is never going to fit all, around reporting". The focus must be "on what drives value for the business", and this will always vary because no two companies are the same.

French connection

Mandatory disclosure of sustainability indicators is hardly a novelty in France. French listed companies have been obliged to report on the **social** and **environmental** impacts of their activities since 2001. However, disclosure requirements have recently been upgraded and are now arguably the world's strictest.

A decree on transparency requirements was adopted in April 2012. It sets out **42** sustainability disclosures companies must make, structured around three themes:

- **social** (19 indicators including, for example, data on gender equality and what the company is doing to eradicate child labour)
- **environmental** (14 indicators including resource use and what climate change adaptation plans the company has)
- "**societal commitments** towards sustainable development" (nine indicators including impact on local development, and promotion of human rights).

These indicators are broadly in line with those found in GRI guidance.

There is a "**comply-or-explain**" principle – companies must provide the information or say why they are failing to do so. The legislation extends reporting requirements to non-listed companies that meet the criteria of having both **€100m** turnover and 500 employees. Non-listed companies must disclose 29 of the 42 indicators. Sustainability data must be **independently verified**.

François Fatoux, executive director at France's Study Centre for Corporate Social Responsibility, says the comply-or-explain principle is "one very positive aspect … which addresses the burden and costs from previous requirements for companies to inform even on matters that were not relevant". But not everyone is happy. The French CSR Citizen Forum is planning a legal challenge on the basis that "comply-or-explain" should simply be "comply".

There could be further developments. During his recent successful election campaign, France's new president, **François Hollande**, called for a "**social rating**" of companies alongside financial ratings, but it is so far unclear exactly what this might mean.

Fatoux says: "Companies need to see sustainability reporting not solely as a burden but also as an **opportunity** to rethink their management system and use it as a guiding tool to add value to their initiatives. Yes there is a cost, but businesses have to turn this into a benefit, as reporting does not necessarily mean additional spending, provided that it also addresses their needs."

Links:

GRI G4 exposure draft: www.globalreporting.org/reporting/latest-guidelines/g4-developments/Pages/default.aspx [2]

Rio+20 conclusions: www.uncsd2012.org/thefuturewewant.html [3]

Overview of French disclosure requirements (in French): www.medef.com/fileadmin/user_upload/www.medef-corporate.fr/document/RSE/MEDEF_-_Guide_Reporting_RSE_-_Mai_2012.pdf [4]

Links:
[1] http://www.ethicalcorp.com/users/stephen-gardner-additional-reporting-sandra-pointel
[2] http://www.globalreporting.org/reporting/latest-guidelines/g4-developments/Pages/default.aspx
[3] http://www.uncsd2012.org/thefuturewewant.html
[4] http://www.medef.com/fileadmin/user_upload/www.medef-corporate.fr/document/RSE/MEDEF_-_Guide_Reporting_RSE_-_Mai_2012.pdf