Mapping the sustainability reporting landscape: Lost in the right direction?

21 June 2016, Brussels

REPORT

On 21 June 2016, ACCA (the Association of Chartered Certified Accountants) and the Climate Disclosure Standards Board (CDSB) organised an event to launch a new ACCA-CDSB report called Mapping the sustainability reporting landscape – Lost in the right direction.

Lois Guthrie, Founding Director, CDSB, presented the report. The panel was moderated by **Jimmy Greer**, Senior Manager, Business Focus, ACCA, and comprised of **Nicolas Bernier-Abad**, DG FISMA, European Commission, **Lars Mueller**, DG ENVI, European Commission, **Flavia Micilotta**, Secretary General Eurosif, **David Szafran**, Lawyer at Law Square and Chair of ISAR 30th session at UNCTAD, **Elisabeth Gambert**, Director CSR & International Affairs, AFEP and Chair of EuropeanIssuers's Corporate Reporting WG. Keynote speeches were delivered by MEP **Cora van Nieuwenhuizen** and **Karl Falkenberg**, Senior Advisor at the European Political Strategy Centre (EPSC) dealing with Sustainable Development.

The debate revealed that a reasonable balance between stakeholder demands and companies' capacity to produce additional information has to be found. It also revealed a clear consensus on the need to enhance the existing dialogue between all parties - regulators, companies, investors, civil society, and other stakeholders - and to agree on common objectives, on common language and common principles to make sustainability reporting more meaningful and create clarity for investors. It was stressed that greater alignment between frameworks, as well as a better understanding of where overlapping requests for information are made, would result in an improved sustainability reporting landscape able to reduce duplication and to build a sense of shared objectives. It was also noted that regulators have a role to play in finding common ground and comparability between the different reporting schemes. The panel also highlighted other areas that merit vigilance, such as the effect on competitiveness, the need for any new practices to have the appropriate legitimacy and better understanding of claims related to directors' liabilities.

<u>Main highlights</u>:

Jimmy Greer, Senior Manager, Business Focus, ACCA

- From the EU Directive on disclosure of non-financial information to the recently created Task Force on Climate-related Financial Disclosures, demand for effective sustainability reporting has never been greater. But while the depth of sustainability reporting continues to improve, the landscape lacks coherence and, as a result, is fragmented and failing to live up to its potential.
- The report we are launching addresses key concerns holding back the discipline and makes a set of common sense proposals aimed at ensuring that it can continue to help companies deliver a prosperous future.

Lois Guthrie, Founding Director, CDSB

- There are a number of activities and developments that are influencing the way companies are preparing their corporate reports. They include: Megatrends - demographic shifts, consumer behaviour, innovation, resource scarcity; COP21 Paris agreement and sustainable development goals; SEC Disclosure Initiative. We also see central bankers becoming interested in climate change related information.
- Reporting on performance requires companies to think about a long list of things: Financial results; Governance practices; Management commentary; Fiduciary duty; Future orientation and scenario analysis; Ethical practices; Value chain; Global commons (as well as owned & controlled assets/operations); Accountability; Shared and inclusive value; Resilience and viability; All capitals.
- What we see at high level is that the system has a long and established history of mainstream reporting (financial, governance statements and management commentary for investors) mainly looked after by organisations like the International Accounting Standards Board.
- At the other end of the system we have the sustainability reporting infrastructure. There is a move to integrate these two in recognition of the fact that companies' performance depends not only on management of their financial results and good governance but also on management of sustainability related risks & opportunities.
- Financial reporting is not perfect but there are things we can learn from it: it has structure; Standards to help with preparation & presentation; Principles that guide disclosure. Standards for reporting forward looking information (new IFRS 9); Cross referencing protocols; Internal controls; Valuation and monetization; Modelling (actuaries).
- What would a similar system look like if it would be enshrined in sustainability reporting? The ACCA-CDSB report introduces common terminology: **Requirement developers** (page 21) - the organisations that issue or influence sustainability

reporting requirements by specifying what information a reporting organisation should provide. There would be **Reporting requirements** - the provisions through which sustainability information is requested, including laws, standards, frameworks and codes. **Reporting content** is the subject matter about which requirement developers demand or request sustainability information through reporting requirements. **Support mechanisms** are the management and governance approaches, measurement tools, systems and procedures that help a company determine how to respond to reporting requirements and prepare and present appropriate content. **Reporting channels** are the mechanisms and places through which information is conveyed to audiences. **Audiences** are the intended users of reported information.

- There is a system of reporting fundamentals: objective, requirement to deliver, content requirements, standard and system for compliance, reporting channel, assurance and verification, review and use of report.
- The report gives six proposals in order to give some structure to reporting. It is important that some of the **technical dilemmas**, such as materiality, boundaries, language and characterization, are resolved to make corporate reporting more effective.
- Another proposal is about **Reciprocity**. Different requirements and different requirement developers are asking for the same types of things to be reported. Proposal 4 (page 38 of the report) suggests that efforts to signal alignment between requirements set by requirement developers and their reciprocity of approach could significantly reduce confusion and clutter in the sustainability reporting landscape.
- Proposal 6 – **the Convention** – suggests a forum to negotiate a form of words that create a harmonised language.
- The Reporting Exchange initiative is a knowledge platform in which the World Business Council for Sustainable Development & CDSB monitor all international provisions that directly or indirectly affect the way in which companies report on sustainability matters.
- CDSB has also done extensive work with the OECD on consistency in reporting. It has also analysed the FTSE350's response to mandatory reporting requirements in the UK.
- We acknowledge that there are technical dilemmas and there are a lot of discussions about them. However, those discussions need to be centralised. We need to think about new measures, think beyond what already exists. Technology might help in solving some issues in non-financial reporting by enabling the user to create their own report from the available data.
- It doesn't matter what people write down, it matters what they actually have done. What a report should do ideally is write down what a company has done. There should be some flexibility but the application of judgement has to take place within certain parameters that represent the expectations of the reader. What makes a huge difference is training in the company.

Nicolas Bernier-Abad, DG FISMA, European Commission

- The idea that companies must get involved in communication of financial and non-financial information in a comprehensive way has gained a lot of attention. Non-financial reporting is new: we have less than 20 years of any practical experience.

- There is legislation on this in Europe since 2003. In 2012 we engaged in a thorough review of the legislation that ended up with a new directive that entered into force in December 2014. The Directive is about material, useful information. It is about strengthening the long-term financial and non-financial performance of companies, more resilient growth and jobs in the EU.
- This legislation clarifies that in their annual management report, large companies in Europe need to include financial and non-financial information. This is not

sustainability reporting – it is company reporting. It is considered necessary information to understand a company.

- In the European Parliament this legislation was adopted with a huge majority. It was a very consensual piece of legislation with almost 600 voted in favour and 55 against.
- The Directive is not prescriptive and avoids undue administrative burden. It gives companies flexibility in deciding the best way to perform this transparency exercise. The requirement is in the law; the methodology is up to the companies.
- Member States are working on the transposition into national legislation. The deadline for that is December 2016. The Commission is working on preparing non-binding guidelines on methodology for companies. It should be ready by December 2016. The public consultation has received more than 350 high-quality responses. Nearly half of the responses came from companies and business associations.
- The guidelines don't need to be operational or a how-to guide but they need to be a value-added document. There is a trade-off between the clarity of the rules and flexibility for companies in determining what is relevant and material.

Lars Mueller, DG ENVI, European Commission

- Preserving, protecting and improving the state of nature are not only fundamental objectives of the EU; Economic progress depends on how we manage to protect our natural capital and biodiversity and make sustained use of ecosystems and the services they offer. The value of nature, ecosystem services and to integrate natural capital into economic decision-making is key to mainstreaming policies that promote sustainable practices.
- As regards the presented ACCA-CDSB report, the use of 'shared overall objectives for leveraging greater coherence' is welcome but one would need to cover the full picture of existing environmental policies and approaches to inform corporate sustainability reporting including natural capital and biodiversity and link to the circular economy package or EMAS.
- The notion of 'Comprehensive mapping and categorisation' makes a lot of sense. However, we need to maintain also in scope all purposes like management of operational, regulatory, reputational and financial risks as well as audiences, notably including customers/consumers – as key for credibility and to avoid unjustified criticism to be greenwashing as is third party verification.
- The "sustainability reporting landscape" is still evolving. Promoting convergence of reporting should not narrow down the scope too early. We will still have to encourage further elaboration of concepts that inform both – the management decision making and then the reporting. This should include the circular economy tools and natural capital accounting. In particular we have to encourage frontrunners.
- The report proposals are a call for further dialogue. The Commission is ready to foster and facilitate it. The EC is committed to working with companies on transforming sustainable environmental practices into a business opportunity. There are three examples that can be given in this area:

1. The EU Eco-Management and Audit Scheme EMAS, provides for many years an opportunity for frontrunners organisations to promote their environmental performance and achievements. Currently more than 4000 organisations (and 9000 sites) are registered. On top of being a robust environmental management tool EMAS also includes a (mandatory) reporting feature requiring registered organisation to report on different core indicators including Biodiversity.
2. The EC plans to explore with companies what type of information they would find useful for Product and Organisation Environmental Footprint and in which way presented. This exploration is part of tests regarding how to communicate Environmental Footprint information to different stakeholders. In 2017, the European Commission will evaluate this pilot phase and based on the learnings it will consider policy applications for it. The Environmental Footprint could potentially support

voluntary policies on measuring and communicating environmental performance, as an environmental pillar of non-financial reporting. See here.

3. The Commission has also established the EU Business and Biodiversity Platform in which companies engage in advancing and showcasing good practices in natural capital and biodiversity management and to showcase business initiatives measuring and reporting their impacts and dependencies on natural capital (e.g. Environmental Profit and Loss Accounts, Natural Capital Balance Sheets).

Flavia Micilotta, Secretary General Eurosif

- It is important to have an open dialogue with companies and to make them understand what are the issues that we are very keen on having disclosed and what is considered material. Companies can very easily get lost in the maze of requirements and guidelines. It is our responsibility to be more proactive and to guide them in the right direction.
- We need to have an alignment of objectives for the reporters and the recipients of the report. It would be very helpful for companies if there would be further reciprocity in the way they define their KPIs.
- CSR rating agencies play a very big role in the area of ESG (environmental, social and governance) reporting. It is through them we find out how sustainable companies are. The ESG analysis has become more mainstream recently.
- However, that doesn't necessarily do much justice to those that are really willing to understand which companies are the most sustainable ones and how they are integrating sustainability into their business model. There is no one way of measuring that. Sometimes we are at risk of duplicating standards.
- Investors would like to have one vision of how sustainability reporting should look like and one understanding how a specific company is performing. Today that is not possible.
- The role of CSR rating agencies is an important one. They have the power to really embed transparency into the way they work. It would be useful to have more clarity on the metrics that these agencies are really using. We should be looking for a dialogue between the main players, bringing together also issuers and investors.

David Szafran, Lawyer at Law Square and Chair of ISAR 30th session at UNCTAD

- There are more and more expectations for directors and managers to disclose the impact of their business on the society. The United Nations have adopted the 17 Sustainable Development Goals. At the UN level different tools were developed within the Corporate Reporting Working Group. These tools aim to assist governments in implementing international standards.
- The UNCTAD publication "**Key-foundations for high-quality corporate reporting: Good practices of monitoring and enforcement, and compliance mechanisms**" presents a graph that shows the UNCTAD-ISAR Accounting Development Tool scores for three sample countries for 24 quantitative indicators (p.20).
- According to the PwC SDG Engagement Survey 2015, 78% citizens say they are likely or very likely to use the goods and services from companies signed up to the Sustainable Development Goals. In many countries it's even higher.
- Law Square and PwC have performed a survey with the largest listed companies in Belgium. It shows that 85 percent of the companies already published sustainable information on a voluntary basis; the majority already includes that information in their management report. 40 percent of the companies refer to the UN Global Compact principles. 65 percent use the Global Reporting Initiative. 40 percent use external assurance on voluntary basis. The recommendation is to put in place as appropriate internal control and risk management mechanism to identify the data and to be able to report on this.

- The UN Global Compact principles include human rights, labour, environment and anticorruption & bribery. It is recommended to fully integrate this with an appropriate risk management process. In order to be able to disclose, it is important to have the policies and the KPIs. The UN provides guidance in the [UN Guide for Anti-Corruption Risk Assessment].
- Recent studies show there is enforcement on director liability. There is also more focus on the roles of independent and non-executive directors.

Elisabeth Gambert, Director CSR & International Affairs, AFEP and Chair of EuropeanIssuers's Corporate Reporting WG

- The ACCA-CDSB report is a timely contribution. Corporate reporting is more and more expected by stakeholders to be concise, material and forward looking which is not an easy exercise for companies.. In addition, companies are facing multiple components of sustainability reporting with a huge variety of national reporting requirements whereas their sustainability challenges are global. One of the main challenges we are facing today is avoiding duplication and lack of clarity.
- The corporate sustainability reporting landscape in France is quite unique as there are extremely detailed legal sustainability reporting requirements including mandatory verification by an independent third party. Companies in France provide a considerable amount of non-financial information: a recent study published by Vigeo in 2015 shows that French companies present the highest level of non-financial information compared to 1000 companies worldwide.
- However, much still needs to be done in France: the implementation of the EU directive presents considerable challenges because it has an entirely different, more principle based logic from the French sustainability reporting framework which is more compliance based.
- New information requirements are constantly being added to the already existing list of reporting requirements. Somewhere this has to stop and a reasonable balance between stakeholder demands and companies' capacity to produce additional information has to be found. This is why the proposal to sit around a table and agree on common objectives and common language and principles seems reasonable. However, in the long term, if we wanted to take this further and work on a draft standard on sustainability reporting, the following traps should be carefully avoided:
  - The **legitimacy trap**: governance is vital here and companies are very keen on transparency on whose interests are behind which initiative and who pays (lessons to be learnt from the implementation of IFRS);
  - The **competitiveness trap**: companies are concerned about increases in costs; the disclosure of sensitive information which could be misused by competitors; increased liability and litigations due to uncertain concepts and extended reporting boundaries; how far should sustainability reporting go?
- Companies are ready to work together with stakeholders to make sustainability reporting more meaningful, keeping in mind that **reporting should address material matters, leave sufficient flexibility to respond to sector specific challenges, and last but not least, apply to all companies** (and not only European ones).
- Large multinational companies often have hundreds of thousands of suppliers. How far can a company go in the management of potential risks on the supply chain? A bill on the liability of parent companies and companies placing orders is currently under discussion in the French parliament and the sanctions for not putting in place due diligence plans are enormous: 10 M € and civil liability for damages caused by suppliers or subcontractors. This poses very great difficulties for companies, including the most virtuous ones because you can never control all the actors on the supply chain and exclude all risks. Things are not sufficiently clear despite excellent guidelines from the OECD.

Cora van Nieuwenhuizen, MEP

- Financial reporting standards have been out there for quite some time and we are still figuring out the details for it. The reason for that is complexity. It is not about the amount of information – it is about its quality. Not everything that is measurable is of value and not everything of value is measurable.
- We need to keep that in mind and focus on relevant information for investors and society. We must be careful not to add unnecessary administrative burden.
- Good leadership is essential - the tone at the top is very relevant. We need to continue the fight and the hard work. It is the time to grasp the momentum.
- Society wants to focus more on long term investments and for that we need to be informed about all aspects of the company. The issue of integrated reporting is moving slowly but it is moving. More and more companies are focusing on sustainability issues. It is necessary to always take a step back and evaluate the situation. A global level playing field is important.

Robin Edme, Ministry of Environment, Energy and the Sea, France, and Chair of the Group of Friends of Paragraph 47 mentioned that the Group has launched a report that surveys five national case studies on corporate sustainability reporting public policies.

- Within the next couple of months, a similar report will be launched but which specifically on the finance industry. We cannot tackle the issue of corporate sustainability reporting without addressing simultaneously the two sides of the same coin, i.e. the issuers (e.g. the companies) and the investors (e.g. the finance industry).
- The corporate sustainability business case unfortunately still remains to be proven, although a lot of progress has been made.
- There is a lack of clear objective about reporting. Unfortunately, there is no clarification in the EU directive about what the objectives are.
- Central issue is now about quality, and materiality is obviously a key driver. But there is a flaw in the way this concept is being sued and developed: The paramount question isn't if information is material or not, but rather to whom it is material. If we made that clear, it would clarify the negotiations with companies.
- There is a true need of convergence of the frameworks.

Karl Falkenberg, Senior Advisor at the European Political Strategy Centre (EPSC) dealing with Sustainable Development

- We often hear that sustainability is complex and that companies have a lot of burden. It is important to highlight that environment is a part of sustainability but it's only one element – sustainability is a much broader concept. To measure all of these aspects is very difficult and it is a challenge for businesses. However, when their activities are affecting society, we cannot be apologetic about that. Companies should be aware of their impact on the broader society.
- A lot of the problems are not seen in the accounts of individual companies and this is at the moment a fundamental problem in our approach. If we would find a way to measure all the impact of the companies, this world would be sustainable.
- Around 80% of European consumers say that they would be prepared to pay a little bit more if they knew that the product was sustainably produced. However, when we look into the real market, we see that it is only around 6-7%. We need to take this into perspective.
- We are all working towards the same goal and there seems to be a widespread acceptance of sustainability as an overarching target. It would be useful to establish comparability between different reporting schemes. We need to come to a basic set of indicators.