



The Evolution of Corporate Reporting for Integrated Performance

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TABLE OF CONTENTS

ACKNOWLEDGEMENTS	2
EXECUTIVE SUMMARY AND QUESTIONS FOR DISCUSSION	4
INTRODUCTION AND DEFINITIONS	6
1. STATE OF PLAY OF REPORTING OF CORPORATE RESPONSIBILITY	8
1.1 Corporate reporting in brief	8
1.2 The emergence of corporate social responsibility	8
1.3 Drivers and status of ESG disclosure	10
The ESG reporting toolkit	11
The regulatory side	13
Quality of ESG reports today	14
2. THE IMPACT OF CORPORATE RESPONSIBILITY	16
2.1 Why companies engage in corporate responsibility: a quick look at economic theory	16
2.2 Evidence of actual impact of corporate responsibility on companies	17
2.3 How do investors look at corporate responsibility? Do ESG disclosures help?	20
3. REPORTING FOR BETTER & INTEGRATED PERFORMANCE	22
3.1 ‘One report’: towards integrated reporting	22
A framework for integrated reporting	23
Going forward with integrated reporting	25
3.2 Monetising corporations’ externalities	25
3.3 Mandatory ESG reporting?	26
CONCLUSION	27
REFERENCES	28
ANNEX A – INSTRUMENTS AND STANDARDS FOR CORPORATE RESPONSIBILITY	33

EXECUTIVE SUMMARY AND QUESTIONS FOR DISCUSSION

Corporations are increasingly looked to as agents of change in a world facing mounting environmental and social problems, where policy-makers sometimes struggle to garner the support necessary for bold policies. As part of their strategy and in response to stakeholder pressure, more and more businesses now go beyond strict compliance with environmental and other local regulations. These businesses want to inform stakeholders, from investors to consumers, about their corporate responsibility efforts. As a result, the corporate disclosure of environmental, social and governance (ESG) aspects has developed in a variety of directions over more than two decades.

In the meantime, the financial crisis cast doubt on corporate reporting as a credible source of information on companies' health. Yet reporting is an essential link in our economies: the provision of financial (and now extra-financial) information about corporations is essential for investors to make proper capital allocation choices, and for other stakeholders.

At present, investors and other stakeholders can be confused by the information in ESG disclosures: it is difficult to compare ESG performance across companies; the reported information sometimes appears disconnected from the company's business lines or products, making it difficult to assess its importance; and it can omit risks and opportunities that are material to the business and to society, despite dozens or even hundreds of pages of less relevant data.

The importance of ESG disclosures should however not be underestimated: they reflect internal processes and changes that can improve a company's strategy and its durability, as well as its contribution to public goods. Such behaviour is to be encouraged in the face of the short-termism of markets, as some investors are increasingly looking for financially robust and resilient companies, and society demands a better allocation of its capital resources.

We have gathered a growing body of evidence according to which companies with a strong ESG record deal better with a range of risks and opportunities – these companies should be attracting more capital than their less ESG-prone counterparts. Corporate responsibility has not hampered companies financially; in fact, durable, strong ESG performance seems to enhance financial performance. This evidence, combined with the contribution of these companies to society, makes a strong case for policy-makers to: 1) push for more company engagement in ESG; and 2) ensure some coordination and alignment across existing frameworks, guidelines and regulations to facilitate progress.

The community of corporate ESG reporting is working to respond to its challenges with new frameworks such as integrated reporting (a single report bringing together financial and ESG aspects, with a narrative on the firm's ability to create value in the future), and various guidelines and practices.

Round Table participants are asked to consider the following questions:

- Are corporate disclosures on non-financial performance being made use of? If so, by whom and with what effects? If not, why? Does corporate reporting need to evolve in order to shift investment behaviour?
- What evolutions of corporate reporting are currently being envisaged, with what motives, and what chances of success? Do we need a new definition of corporate performance? What would be the consequences for financial capital valuation methods and reporting?
- What role can governments and regulations play in an area where voluntary initiatives abound? What role can stock exchanges play?

- What information would motivate financial markets to become part of the leadership that will put us on a long-term sustainable trajectory? How can we overcome the “short-termism” in investment decision-making often identified as a critical barrier to addressing sustainability challenges? How can investments in sustainability be stimulated?

INTRODUCTION AND DEFINITIONS

Investors have lost trust in corporate information since the global financial crisis.

ACCA (2013b)

Nor is [corporate ESG] information provided in any meaningful way that can be compared with figures for their peers.

David Blood, Generation Investment Management, in (ACCA, 2013b)

1. The disclosure of corporate environmental, social and governance aspects has recently become a topic of much attention. Global and local impacts of corporate activities (human rights, climate, air, soil and water pollution) are under much scrutiny from civil society, and companies are being held accountable for misdeeds across their full value chains (e.g. the death of 1,138 Rana Plaza workers in 2013). At the same time, a large and continuously growing number of companies are reporting voluntarily on ESG aspects of their activities.
2. ESG disclosures emerged as part of corporate social responsibility (CSR, also known as corporate sustainability and responsibility) on a voluntary basis, as a means for companies to present their actions beyond strict compliance. They have also been encouraged by the international community, stakeholders and governments through various guidelines, and again recently at the Rio+20 Summit in 2012.¹ Some countries and regions are mandating ESG reporting for listed companies or those above a certain size.
3. For years, companies developed their own performance indicators and measurement methods;² responsible investors and accounting and auditing firms pushed for the development of guidelines or a common practice for ESG reporting, and some homogeneity is now emerging. There are nonetheless questions about the usefulness of the masses of information produced to detail companies' corporate responsibility performance. Yet good practice in this area turns out to be critical for the achievement of stable economic growth (companies that manage risk better last longer) and for more effective solutions to mounting environmental problems, even if the burden cannot fall on companies' shoulders alone. Transparency and comparability of corporate performance in ESG must become the topic of policy-making: it is not a luxury that only financially wealthy companies indulge in – good practice in this area should be rewarded and become a distinctive feature for investors. A proper alignment of society's and investors' aspirations should be the goal: notwithstanding the importance of public policy to address externalities, corporate ESG disclosure is an important link – *also* because it already drives and could further drive corporate change.
4. This paper provides the state-of-play on ESG reporting, starting with an overview of corporate responsibility and what tools have governed its evolution so far. Section 2 summarises the latest findings about what corporate responsibility has meant for companies, more from a macro- rather than micro-perspective. Section 3 describes the latest proposals for an evolution of corporate reporting.

¹ Under paragraph 47 of the Rio+20 conclusions, countries encourage companies to integrate sustainability information in their reporting cycle and to develop best practice in this area (United Nations, 2012).

² Balance scorecard metrics is an example of an innovative measurement instrument helping companies to form better strategies by looking beyond financial performance.

5. Several terms and acronyms are used throughout this paper, and are central to the issue:

Corporate Social Responsibility: the integration by companies, on a voluntary basis, of social and environmental concerns, which reflects perceptibly on their internal operations and relations with stakeholders. Two important notions govern this definition: 1) voluntary: going beyond compliance; and 2) perceptible: CSR must result in marked changes in the company's activities (Kitzmüller and Shimshack, 2012). The European Commission recently defined CSR as "the responsibility of enterprises for their impacts on society" (EC, 2011). Companies now use various terms when reporting on their CSR activities, including: sustainability; corporate responsibility; sustainable development; corporate citizenship; people, planet, profit; or environmental and social report (KPMG, 2013). This variety is a sign of more elaborate strategies, going beyond purely philanthropic activities.

ESG: Environmental, social and governance aspects of companies' activities, typically covered by corporate social responsibility.

Integrated reporting (IR): the disclosure by a company of information on its near, medium and long term capacity to generate value, including material risks and opportunities related to all its capitals: financial, manufactured, intellectual, human, social and relationship, and natural (IIRC, 2013).

Integrated performance: a company's performance once it has integrated the extra-financial dimensions of its actions, taken the full measure of its other, non-financial, capitals and reflected them in its business model.

Integrated thinking: "the active consideration by an organization of the relationships between its various operating and functional units and the capitals that the organization uses and affects. Integrated thinking leads to integrated decision-making and actions that consider the creation of value over the short, medium and long term. Integrated thinking can be contrasted with traditional 'silo thinking'" (IIRC, 2013).

Materiality: There are two distinct definitions of materiality relevant to corporate reporting: 1) the materiality of what a company does ("material aspects are those that reflect the organization's significant economic, environmental and social impacts; or substantively influence the assessments and decisions of stakeholders" [GRI, 2013a]); 2) materiality from the standpoint of an investor in a company (the International Accounting Standards Committee states that "Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements" [IASB, 1999]).

Both notions matter for our discussion: the first definition addresses how stakeholders other than investors may consider the company. The second addresses risks and opportunities from a financial performance perspective. Materiality is also a critical concept for companies because the identification of material aspects requires a close, inward look at the company's activities and stakeholders, and generates information that supports the identification of risks, better decision-making and therefore long-term value creation.

1. CORPORATE RESPONSIBILITY REPORTING: THE STATE OF PLAY

1.1 Corporate reporting in brief

A strong disclosure regime can help to attract capital and maintain confidence in the capital markets. By contrast, weak disclosure and non-transparent practices can contribute to unethical behaviour and to a loss of market integrity at great cost, not just to the company and its shareholders but also to the economy as a whole.

OECD Principles of Corporate Governance (2004)

6. Reporting has long been an inherent part of the life of companies. The OECD Principles of Corporate Governance, a recognised international benchmark, state that disclosure should include, but not be limited to, material information on a company's:

- financial and operating results;
- objectives;
- foreseeable risk factors.

7. The Principles stress that reporting should be realised in accordance with high quality standards of accounting and financial and non-financial disclosure, and that an independent audit should be conducted to assure that all material aspects are properly represented.³

8. Widely accepted instruments such as the International Financial Reporting Standards or the US national Generally Accepted Accounting Principles (GAAP) provide a reference for the disclosure of information by listed companies. The common understanding of these standards and regulations set by securities commissions is to help primarily capital providers, but also public authorities and potential investors, understand the financial performance of companies. Not all companies are subject to the same reporting rules, however: publicly listed companies tend to be subject to the highest scrutiny (e.g. publication of quarterly earnings reports and annual reports including financial statements), while privately-owned companies have more freedom in choosing what information they disclose to the general public.

9. Accounting and disclosure of non-financial elements does not, at present, benefit from a universally-recognised standard. Reporting of these elements has nonetheless grown tremendously over the past two decades, as companies acknowledge their responsibility for matters beyond those of a strictly financial nature and, for some, progressively see the value of a more holistic approach to performance.

1.2 The emergence of corporate social responsibility

10. The concept of corporate responsibility is often traced back to Howard Bowen's book, "Social Responsibilities of the Businessman", although references to similar notions date back several decades.⁴ At

³ OECD, 2004. The principles are not binding, but meant to provide a reference point. They are currently under review.

⁴ Okoye (2009) finds signs of corporate social responsibility in the late 1920s. Katsoulakos et al. (2004) provide an earlier quote from a 1916 article by J.M. Clark in the Journal of Political Economy: "if men are responsible for the known results of their actions, business responsibilities must include the known results of business dealings, whether these have been recognised by law or not".

the same time, the breadth of the CSR concept (social, human rights, local and global environment) makes pinpointing a start date illusory. It has been an incremental process, which became more visible as specific cases were brought to the public eye (e.g. catastrophic oil spills⁵ or labour abuse leading to demands for more transparency and disclosure regarding companies' conduct) and through intergovernmental processes such as the 1972 UN Conference on the Human Environment in Stockholm, the Brundtland Commission (UN, 1987), the 1992 Earth Summit in Rio de Janeiro and ensuing conventions.⁶ Intergovernmental efforts outside the environment field also initiated changes in corporate responsibility: in 1974, the UN created a commission to study the impact of transnational corporations, with a view to creating a code of conduct.⁷ At the OECD, Guidelines for Multinational Enterprises were first adopted in 1976.

11. There are many justifications and theories for the emergence of companies' responsibility beyond the financial responsibility to their shareholders. They include: new awareness (on the part of stakeholders and management); growing and visible environmental pressures; policy gaps in the protection of public goods; and material risks, including reputational. These convey a rather defensive view of why companies engage in CSR. While this may have been the early justification for such actions, CSR has also undoubtedly led some companies to find new opportunities to create value and ensure their durability, including through the prevention of new risks. Some companies are "taking the offensive", setting targets publicly in recognition of serious global problems such as climate change, and as a means to differentiate themselves from less responsive companies (Kramer and Kania, 2006). Other companies were established by visionary entrepreneurs with good corporate responsibility as their foundation.

12. Today, stakeholders (employees, local communities, non-government organisations, customers and investors) increasingly turn to a company's management and shareholders, asking if its business practices take full account of the environmental and social dimensions of its activities, and if its governance structures (ESG) meet the expectations of society.

13. A growing number of corporations are now engaged in a broad set of ESG activities. The following is an incomplete list of matters that companies commonly address as part of responsibilities going beyond compliance with national and international legislation:⁸

- Resource efficiency (energy, water and land use and management, other materials);
- Release of regulated and unregulated pollutants (e.g. greenhouse gases);
- Production of hazardous waste;
- Impacts on biodiversity and ecosystem services;
- Sourcing of materials (e.g. the use of conflict minerals, trafficking), certification;
- Use of green products in production and environmental performance of products;
- Corruption;
- Human rights;
- Health and safety;
- Employment, labour conditions, training, gender balance, turnover rate (talent management and retention);

⁵ Ceres, initially a small group of investors, was founded largely in response to the Exxon Valdez oil spill in 1989.

⁶ At the 1992 Earth Summit in Rio, a group of 48 companies created the Business Council for Sustainable Development, which later became the World Business Council for Sustainable Development.

⁷ The commission was dissolved in 1994 without having agreed to a code of conduct, but its work paved the way for the UN Global Compact adopted in 1999.

⁸ This list is partly based on Hesse (2012) and on GRI (2013).

- Communication with stakeholders (investors, suppliers, customers, employees, non-governmental organisations, authorities, communities);
- Corporate governance (e.g. composition of the board of directors, communication with stakeholders, executive compensation).

14. The management of these and other ESG aspects requires that companies identify performance indicators, set appropriate measurement methods, develop data management systems and controls, and establish internal decision-making processes to address potential risks and opportunities. Disclosure of this information should be considered one, but certainly not a unique, outcome of companies' ESG activities. More importantly, these activities can improve decision-making, helping to offset risk (brand, reputation, and regulatory), enhance efficiency, and increase revenues and market shares via innovation or a stronger brand reputation, to name a few.

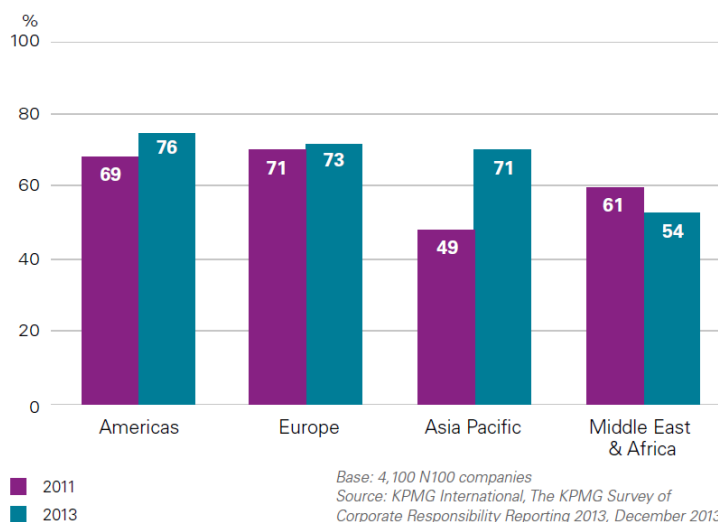
1.3 Drivers and status of ESG disclosure

Corporate responsibility reporting is – or should be – an essential business management tool. It is not – or should not be – something produced simply to mollify potential critics and polish the corporate halo.

Yvo de Boer (KPMG, 2013)

15. Corporate reporting on ESG aspects is now a widespread activity, at least among large companies. KPMG (2013) indicates that 71 percent of the top 100 companies in 41 countries now report on ESG, against 64 percent in 2011, with some countries (e.g. India) displaying spectacular growth over the period (20 percent to 73 percent). Such progress is sometimes the result of new regulation.⁹

Figure 1. Corporate responsibility reporting by region (percentage of companies with CR reports)



Note: Based on a KPMG survey of the 100 largest companies in 41 countries (KPMG, 2013)

⁹ India's Security Exchange Board mandates top 100 listed companies to adopt the country's National Voluntary Guidelines for Social, Environmental and Economic Responsibilities of Business (KPMG 2013).

16. There are various reasons for today's diversity in corporate ESG disclosure: the voluntary nature of corporate responsibility activities for some companies; the evolving range of stakeholders; and the growing number of issues that companies are asked to tackle (e.g. recently, on climate change vulnerability).

The ESG reporting toolkit

17. This section focuses on the current, well-established tools in the ESG reporting kit. New evolutions (integrated reporting in particular) are covered in more detail in Section 3.

18. We propose the following typology of instruments mobilised in ESG reporting, going from the general to the more specific:

- principles;
- guidelines;
- standards;
- methods.

Annex A provides a more complete list of corporate responsibility instruments, including sector- and issue-specific.

19. The following are examples of **principles** for corporate reporting, established by major, visible organisations. Some relate to a subset of ESG aspects, e.g. human rights; others seek to be broadly encompassing.

- The OECD Guidelines for Multinational Enterprises (MNE Guidelines), a set of recommendations adopted by governments, addressed to multinational companies that operate in or from adhering countries. The Guidelines encourage a second set of disclosure covering social, environmental and risk dimensions, in addition to financial, performance, ownership and governance, (OECD, 2011). The MNE Guidelines do not mandate any specific reporting format, but introduce a formal system of National Contact Points that stakeholders can approach if a company does not respect the principles of the Guidelines. As of 2014, all 34 OECD countries and eight non-member countries¹⁰ adhere to the Guidelines.
- The UN Global Compact, which companies and NGOs can adhere to, has ten principles in the areas of human rights, labour, the environment and anti-corruption (UNGC, 1999). As of 2014, it reported some 8,000 corporate participants. Corporations must report regularly to the UNGC, via a 'communication of progress'. The Global Compact does not mandate any reporting framework, but its website states: "GRI [the Global Reporting Initiative] is a practical expression of the Global Compact."¹¹
- The UN Guiding Principles on Business and Human Rights, endorsed by the UN Human Rights Council in 2011. These principles include several references to reporting, but do not mandate any particular format. The OECD MNE guidelines were amended in 2010 to include a chapter on human rights consistent with the UN Guiding Principles (OECD, 2011).

¹⁰ Argentina, Brazil, Egypt, Latvia, Lithuania, Morocco, Peru and Romania.

¹¹ The two organisations created a strategic alliance in 2006, the UNGC-GRI Value Platform.

- ISO 26000: Social Responsibility. In spite of being published by the International Organization of Standardization, and labelled an “ISO International Standard”, ISO 26000 only represents a global consensus on the state of the art of the topic, and cannot be subject for certification – i.e. it is not, strictly speaking, a standard. It covers a broad range of CSR dimensions¹², but does not offer specific guidance on reporting (GRI, 2010).
- The International Finance Corporation Performance Standards on Environmental and Social Sustainability, which establish codes of conduct for IFC clients (IFC, 2012), in eight areas (including the assessment and management of environmental and social risks and impacts, biodiversity, or cultural heritage). The IFC does not prescribe any specific reporting framework for these activities.
- More recently, in the conclusions of the Rio+20 summit, countries “acknowledge the importance of corporate sustainability reporting and encourage companies, where appropriate, especially publicly listed and large companies, to consider integrating sustainability information into their reporting cycle.” (United Nations, 2012).

20. As for actual **guidelines** for ESG reporting – i.e. practical advice on how to structure a report on corporate responsibility – the Global Reporting Initiative (GRI) is emerging as a leader. GRI was created in 1997 by Ceres¹³ and the United Nations Environment Programme to provide guidance on sustainability reporting – i.e. specific elements that a corporate sustainability report could include. GRI recently issued *G4 Sustainability Reporting Guidelines*.¹⁴ GRI recommends third-party assurance of a company’s report, but does not require it (GRI, 2013a).¹⁵

21. The Carbon Disclosure Project questionnaire is another example of reporting guidelines, in this case focusing on climate, water, and forests (CDP, 2013). CDP offers its questionnaire for large companies to report on the management of the climate change issue, including: the company’s emissions for various scopes, emissions reduction objectives and management of climate-related risk. Companies decide whether or not their information will be made public once collected by CDP.

22. There are few, if any, **standards** in the field of ESG reporting, i.e. reporting methods that include the certification of the final report, conducted by a specially-accredited organisation:

- The European Union Eco-Management and Audit Scheme (EMAS) can be used by companies that have measured their environmental impacts, committed to reduce them, and developed an environmental management system (EMS) to that effect. Participating companies must have all elements of the EMS, including its environmental statement, audited by an accredited environmental verifier (EC, 2014).
- ISO standard 14064-1 provides “guidance at the organization level for the quantification and reporting of greenhouse gas emissions and removals” (ISO, 2014).

¹² Governance, human rights, labour practices, the environment, fair operating practices, consumer issues, community involvement and development (ISO, 2014).

¹³ “Ceres is an advocate for sustainability leadership. Ceres mobilizes a powerful network of investors, companies and public interest groups to accelerate and expand the adoption of sustainable business practices and solutions to build a healthy global economy”. www.ceres.org, viewed on 1 April 2014.

¹⁴ Companies using the GRI guidelines for sustainability reporting can decide to do so ‘in accordance with’ the guidelines, or, more simply, to use some of the Standard Disclosures from the guidelines.

¹⁵ As such, it is therefore not a standard. Standards require certification to be deemed valid.

Issue-specific standards abound, however, e.g.: the Forest Stewardship Council, the Marine Stewardship Council, the Programme for the Endorsement of Forest Certification, Responsible Jewellery Care Certification, or the GoodWeave Child-Labor Free Certificate.

23. The Sustainability Accountability Standards Board (SASB) and the Climate Disclosure Standards Board (CDSB) are currently working on new reporting standards. SASB, accredited by the American National Standards Institute, is developing industry-by-industry standards for the reporting of material sustainability issues by corporations listed in the United States to be used in their standards filings to the Security Exchange Commission. CDSB is expanding its Reporting Framework beyond climate to include water and forest commodities with the aim of integrating non-financial information into mainstream corporate reports.

24. In this typology of reporting instruments, measurement **methods** provide tools for quantifying companies' various non-financial impacts. It is common for companies to rely on their own key performance indicators, but certain tools, developed in discussion with the private sector, are now used by many companies in support of their reporting. For instance, the Greenhouse Gas Protocol, developed by the World Resources Institute and WBCSD, is recommended by many of the approaches listed above. Sectors including cement, steel, aluminium or chemicals have adopted, and then adapted, the WBCSD-WRI GHG Protocol. Another example is ISO 14044 (on environmental management), which sets requirements and guidelines for life-cycle assessment.

The regulatory side

The relationship between mandatory and voluntary approaches is framed differently today [...] The report or explain approach is gaining traction, using a mix of mandatory requirements (report) and voluntary prompts (the choice to report, and explain why if you do not).

KPMG et al. (2013) *Carrots and Sticks*

25. The practice of ESG disclosure has largely developed on a voluntary basis, even if intergovernmental bodies nudged companies to become active in corporate responsibility. Corporate sustainability reporting has become a tool that governments and market institutions use to enhance the information of stakeholders on major companies and to ensure that these companies act as good corporate citizens. Transparent and credible ESG reports should be seen as signs of stability and effective risk management by companies.

26. The appropriately named *Carrots and Sticks* report (KPMG et al., 2013) surveyed the policy practice on corporate reporting in 45 countries and identified 134 “separate mandatory policies covering different aspects of [Corporate Responsibility] reporting and a further 53 voluntary policies”. Here is a small sample of current public policies in ESG reporting:

- In **Brazil**, the Sao Paulo stock exchange requires that listed companies apply a report-or-explain approach to corporate responsibility. This initiative was recently scaled up to cover integrated reports and has been renamed “Report or explain for Sustainability or Integrated Reports”.¹⁶
- **China** introduced a reporting requirement for state-owned enterprises via its State-owned Assets Supervision and Administration Commission (SASAC) in 2008. The Shenzhen,

¹⁶ <http://www.bmfbovespa.com.br/en-us/markets/equities/companies/sustainability-report.aspx?Idioma=en-us>

Shanghai and Hong Kong stock exchanges introduced reporting CSR guidelines for listed companies.

- **Denmark** has mandated CSR reporting for large companies (state-owned, listed and others) since 2009 – the requirement also applies to institutional investors. Companies can, however, state that they do not to have a CSR policy, and are then exempted from reporting.
- The **EU** recently agreed to a mandatory report or explain approach on “non-financial and diversity information by certain large companies”. The EU does not mandate a specific reporting framework but lists available options (UN, OECD, ISO, ILO, GRI, *inter alia*) (European Commission, 2013; Compliance Week, 2014). In addition, a number of instruments mandate reporting on specific indicators as part of EU policies such as the Emissions Trading System.
- **France** introduced legislations imposing CSR reporting in 2001 and 2012, obligatory for companies of more than 500 employees, with a comply-or-explain approach and third-party verification of the CSR information. Environmental and social aspects are to be reported in the company’s annual report – a move towards integrated reporting.
- In **India**, the top 100 listed companies are now required to include ESG in their annual reports, following the adoption of the country’s guidelines for social, environmental and economic responsibilities (KPMG, 2013).
- **Norway** passed legislation in 2013 mandating large companies to report on how they integrate their broad social responsibilities into their strategies, with a report or explain approach. It refers to GRI and the UN Global Compact, and does not *a priori* seek to develop any new reporting framework for this legislation.
- **South Africa** now has a long history of corporate responsibility reporting. Recently, the King Code of Governance Principles for South Africa 2009 (known as King III) established voluntary guidelines, adopted by the Johannesburg stock exchange as a listing requirement, on an apply-or-explain basis.

27. Not all major economies have established legislation fostering full ESG reporting. Notable exceptions include the United States.¹⁷ In that case, the requirement for listed companies to report on all things material, via the Securities and Exchange Commission Form 10-K, does create an opening for such reporting – hence the efforts of SASB to establish standards on materiality reporting. As global players, many US companies report on their corporate responsibility: more than half of the companies on Standard & Poor’s 500 list of US companies now do so (KPMG et al., 2013).

28. When no mandatory requirement is in place, companies can remain reluctant to investing seriously in CSR reporting, arguing the absence of an established best practice (ACCA, 2013b). KPMG et al. (2013) also points to the abundance of guidelines, principles, standards and methods, and the confusion that this creates for companies and users of ESG disclosure.

Quality of ESG reports today

29. Among large companies, reporting on ESG is not universal, even if there is general progress on a global basis, according to KPMG’s survey of the top 100 companies in 41 countries (KPMG International, 2013). In a closer look at the top 250 global companies, the survey finds a wide spread of quality depending on whether companies are screened by sector, country or dimensions of ESG report (e.g. targets

¹⁷ However, there are many issue-specific requirements, e.g. under section 1504 of the Dodd-Frank act, on payments to foreign governments; the Sarbanes-Oxley Act of 2002, imposing that US-listed companies increase transparency on their corporate governance; the Greenhouse Gas Rule, mandating reporting of emissions for emitters, suppliers of fossil fuels and industrial gases (Reporting Développement Durable, 2014).

& indicators; materiality; strategy, risk & opportunity; etc.). The survey finds that targets and indicators are usually well documented, whereas suppliers and value chain, and stakeholder engagement, are areas where reporting could be improved.

30. In some countries (e.g. China), corporate reports may lack quantified information. In South Africa, where integrated reporting is mandatory for listed companies, coverage is broad, without evidence that companies screened material elements (PWC, 2014). In the US, the SEC interpretive guidance on climate disclosure seems to have had limited effects, with 59 percent of S&P 500 companies reporting on climate. The quality of climate disclosure for those that do report is measured around 5 on a scale of 100 (Ceres, 2014). Looking at a sample of companies in six industries (auto manufacturing, utilities, real estate, insurance, bank, airlines) Eccles et al. (2012) indicate that most did not disclose climate-related information or relied on boilerplate statements, i.e. “generic language about potential risks from future regulation and the inability to quantify financial impacts.”

31. In their publication *Reporting Matters*, the World Business Council for Sustainable Development reviewed the corporate ESG disclosures of its member companies and identified a number of areas of possible improvement. The following are some of the noteworthy WBCSD recommendations (WBCSD, 2013b):

- Boundaries: state more clearly whether subsidiaries, joint ventures and the value chain of the company are reflected in the report.
- Materiality: describe the materiality process, involving stakeholders, and present findings in their relevant context (water scarcity in some, not all regions of operation; GHG intensity of electricity, etc.)¹⁸
- Strategy: present a vision of how ESG is integrated in the company’s strategy. There is a tendency to focus on sustainability-related risks and not on commercial value or innovation.
- Governance: describe the engagement of the board and management in sustainability decisions, including at local level.
- Evidence of activities: use case studies related to material issues, linked to strategy and with tangible outcomes.
- Key performance indicators on ESG issues should be linked to financial statements, be comparable across companies in the sector; corrective measures should be included when performance is unsatisfactory.
- Targets: should be set for more than a couple of years ahead, and presented with measures taken to ensure their achievement.
- Stakeholder engagement: the report should include how the company answers to stakeholders concerns, including fines and non-compliance incidents in the reporting period.

32. Corporate sustainability reporting is an intricate, competitive web of principles, guidelines and methodologies, with some practices being rapidly diffused among companies. The GRI guidelines provide a well-established framework, including for companies that had developed their own tools (Hohnen, 2012). But there is still a plethora of options for ESG reporting, and with it a sense of inflation of ESG disclosure. The quality and relevance of ESG information vary greatly, even where ESG disclosure is mandatory. Progress is being made, but it is legitimate to ask whether the path from corporate ESG activities to their disclosure and ensuing decisions by stakeholders (investors included) could be more effective.

¹⁸ Only 21 WBCSD members focused their reporting on sustainability issues identified as material to them. For others, more information is provided than is necessary to assess ESG-related risks and opportunities.

2. THE IMPACT OF CORPORATE RESPONSIBILITY

33. Corporate disclosure on ESG is too often perceived as the communication end or the result of corporate responsibility policies. In fact, it stands at both ends: the data and indicators that the production of the report requires are tools that a company's management can use as input to its strategic planning. The corporate responsibility report is also a communication tool to provide reassurance to stakeholders about a company's behaviour beyond its financial performance. It is now generally understood that the exercise of ESG reporting (i.e. not just the resulting report) can be a tool in a company's business strategy, not just a public relations exercise.

34. It is quite common to read interviews of CEOs that indicate how the measurement (and reporting) of non-financial aspects of their companies helped management to identify serious problems and opportunities, and to redefine certain strategies. This benefit has actually been the topic of applied research, as academics debate the value of undertaking activities which, at first, seemed to distract corporations from their profit-making logic.

2.1 Why companies engage in corporate responsibility: a quick look at economic theory

A fundamental economic understanding of CSR is emerging.

Kitzmüller and Shimshack, (2013) *Journal of Economic Literature*

35. Economists have struggled to explain why companies should engage in CSR. A somewhat extreme starting point was provided by Friedman (1970): "There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say engage in open and free competition without deception or fraud." According to this neo-classical view, a management's decision to allocate resources to CSR is a sign of 'moral hazard', whether the manager is motivated by altruism, or by self-interest – for instance, a CEO engages in CSR activities to attract support from stakeholders, building a positive reputation for the company as a way to secure his or her position.¹⁹

36. After several decades of observations, there appear to be more business-oriented reasons for companies' engagement in corporate responsibility that go beyond philanthropy or the entrenchment strategies of CEOs. Many theories try to explain the development of corporate social responsibility. They can be grouped into two categories:²⁰

- **Innovation-driven CSR** (derived from the Porter hypothesis; Porter, 1991): a company views CSR activities as a form of investment towards finding new pockets of productivity improvements, e.g. eco-system services that will avoid capital outlays. This assumes the existence of inefficiencies that can be resolved through actions meant to improve the firm's environmental performance and in so doing reduce expenditure on raw materials.

¹⁹ Cespa and Cestone (2006), cited in Kitzmüller and Shimshack (2012). Along the same line, the shareholders may decide to engage some of the company's money in philanthropic activities instead of "bonus payments for top management to stellar amounts" (Kitzmüller and Shimshack, 2012).

²⁰ This section is largely based on Kitzmüller and Shimshack (2012), and Salanié and Treich (2008).

- **Strategic CSR** corresponds to a company's response to shareholders' and stakeholders' changing preferences. Among the many theoretical motivations in this rubric are:
 - **Consumer markets:** enhancing the attractiveness and differentiation of products among consumers whose preferences lean more toward ESG aspects. Such behaviour is therefore more likely in jurisdictions where consumer lobbies are powerful.
 - **Politics**, both private (NGO and activists campaigns) and public (regulations): companies can build CSR to ward off activist campaigns that could damage their or their products' reputation. In the case of public intervention, a company may decide to over-comply with ESG regulations to deter the government from further intervention, or to demand such intervention, thus creating an entry barrier for competitors.
 - **Labour markets** (employee screening): CSR may raise the attractiveness of a company in the labour market, and even allow lower wages by attracting more motivated employees.
 - **Business-as-usual:** a company's motive is to paint improvements driven by technical progress and increasing resource prices as an additional effort for the environment. There is not, in this case, any special effort by the company to improve on its ESG performance, but a misrepresentation of good management with a view to appealing to consumers or other stakeholders.

37. Kitzmueller and Shimshack (2012) find that, in the above list, the theories that are backed by empirical analysis are those related to the consumer markets and to public and private politics. Studies looking at innovation-driven CSR have found no systematic evidence, and economic studies “*favor a mild negative relationship between environmental performance and overall competitiveness*” (emphasis added). We revisit this issue below, in light of recent work in the management sphere.

38. Overall, the economic literature does find empirical evidence that ESG aspects have become strategic for companies, much as argued by Freeman (2002), with his stakeholder theory of the modern corporation.

2.2 Evidence of actual impact of corporate responsibility on companies

By and large, empirical economic literature reports a positive (even if small) impact of CSR on firms' performance. CSR therefore appears as a new source of growth for OECD countries.

Crifo and Rebérioux (2013)

39. This paper cannot do justice to the breadth of corporate actions in the ESG sphere. It is clear that, for the most part, these activities are very far from what was once considered ‘business-as-usual’ – i.e. mere compliance with domestic laws, sophisticated communication, and no more. Some companies have clearly adopted a stakeholder model, as opposed to a stricter shareholder model, and in so doing are innovating through a better understanding and use of their various ‘capitals’: financial, manufactured, intellectual, human, social, and natural (IIRC, 2013).

40. Here are a few ways that companies have used their knowledge of ESG aspects to improve their performance:

- Company-wide data on CO₂ emissions and corresponding energy use helps to identify best practice and cost savings. CDP (2014) documents that projects to reduce CO₂ emissions, documented via CDP's Carbon Action, have generated an average return on investment of 33% for a total of 169 MtCO₂ avoided. They report that companies with CO₂ targets are much more likely to invest in saving emissions, and to reap the associated economic benefits.
- Corporate ecosystem valuation can improve the management of resources that a business depends on (e.g. water in forestry). Ecosystem evaluation has been used by a number of companies, leading to better management, conservation or expansion of the natural capital (e.g. watershed, wetland, pollinators). Ecosystem management can also improve stakeholder engagement, secure licence to operate, and create opportunities through product differentiation and access to environmental markets (WBCSD, 2011).
- On the social side, observations on internal mobility and reliance on the external labour market can guide internal policies to develop a company's intellectual capital, and to ensure employee retention (Solvay, 2014). Engagement with local communities, beyond improving a company's licence to operate, can be an opportunity to create markets via the training of professionals in the use of a company's product (Lafarge, 2012).
- Companies can also progress through a better understanding and measurement of their socio-economic impacts. Benefits include: obtaining or maintaining license to operate; improving the business enabling environment (i.e. public politics); strengthening value chains; or fuelling product and service innovation. Examples include AkzoNobel's development of high-potential health and nutrition products thanks to a review of its contribution to the Millennium Development Goals, or Coca Cola's 5by20 initiative to empower 5 million women in its value chain by 2020, based on its observation of women's contribution in some of their markets (WBCSD, 2013a).

41. A central question is of course whether companies that enhance their corporate responsibility activities gain an advantage over companies that do not – i.e. does such a strategy work for them? This is not a one-dimensional question, even if an obvious place to start is these companies' financial performance. Marti et al. (2013) recall the two opposing theses on this matter:

- CSR activities only increase costs and therefore lower the financial performance of companies.
- Strategic CSR can improve a company's legitimacy and competitive edge via accessing better resources, attracting new customers, minimising regulation, avoiding conflicts, i.e. public and private politics.²¹

42. One of the most quoted analyses (Margolis, Elfenbeim and Walsh, 2007) reviewed 167 studies on the relationship between profitability and CSR, spanning 1972 to 2007. Their basic finding is a small positive correlation between social performance and profitability. They also point out that high profitability can determine social performance as much as the opposite.

43. Collison et al. (2008) assess the financial performance of companies that are included in the FTSE4Good list – i.e. meet corporate social responsibility criteria. They find that “investors who invest in a portfolio of companies that satisfy FTSE4Good's corporate social responsibility criteria do no worse than

²¹ The academic literature on the topic usually adds to this thesis that the causal link may be reverse: it is *because* a company is competitive and wealthy that it can afford expenditures in CSR.

their counterparts who do not follow a socially responsible strategy when purchasing equities.” In their survey of the topic, Capelle-Blancard and Monjon (2011) find that the financial performance of socially responsible investment (SRI) funds is on average neither better nor worse than that of more traditional funds.

44. Cavaco and Crifo (2014) sought to clarify why the literature is inconclusive on the topic by looking at three separate components of corporate responsibility (environment, human resources, suppliers and customers engagement) for 595 companies in 15 European countries over the 2002-2007 period. High performance in environment and human resources or in environment and stakeholder engagement tends to affect the long-term value of the firm negatively, whereas a combination of efforts in human resources and stakeholder engagement tends to enhance it. In other words, the link between a company’s financial performance and its engagement in CSR depends on which of the pillars of CSR it engages in.

45. More recent observations provide insights on how well companies have fared through the financial crisis, and whether their performance had anything to do with their efforts in the ESG sphere. In the midst of the crisis, Mahler et al (2009) compared the financial performance of companies listed in the Dow Jones Sustainability Index or the Goldman Sachs SUSTAIN focus list with average market performance. Sustainability-oriented companies outperformed the market in 16 out of 18 industries, with performance differentials of 10 and 15 percent over a three-month and six-month period, respectively. Marti et al. (2013) assessed the performance of the 153 companies in the Stoxx Europe Sustainability Index between 2007 and 2010, a subset of the Stoxx Europe 600 Index.²² In this study, the financial performance of companies, measured with three different metrics, is positively correlated to their sustainability over that period: “companies with more socially responsible activities improve the shareholders’ return, incurring higher [corporate financial performance].”

46. Eccles, Ioannou and Serafeim (2013) ask a highly relevant yet original question: how do companies that have adopted high ESG standards perform financially over long periods of time?

“The overarching thesis of our work is that organizations that voluntarily integrate environmental and social policies in their business model represent a fundamentally distinct type of the modern corporation, characterized by a governance structure that in addition to financial performance, accounts for the environmental and social impact of the company, a long-term approach towards maximizing inter-temporal profits, an active stakeholder management process, and more developed measurement and reporting systems.” (Eccles, Ioannou and Serafeim, p.3)

47. Their analysis uses a sample of 180 US companies identified as high and low sustainability, operating in the same sectors and of similar sizes, measured from 1990-1993. In this sample, 90 high sustainability companies have introduced environmental and social policies since the early and mid-1990s. Generally, these companies are more likely than their low sustainability counterparts to have: linked executive compensation to CSR performance; created a committee board for sustainability; and established stakeholder engagement processes. There is also evidence of a long-term sustainability orientation by these companies.²³

48. The results are striking. As of 1992-94, high and low sustainability companies show very similar financial performance. The picture changes, however, when considering longer periods of time: high-

²² Companies on the sustainability index are re-selected annually, based on sustainability criteria.

²³ “For example, after Paul Polman became the CEO of Unilever and announced the implementation of the Sustainable Living Plan while abolishing quarterly earnings reports, ownership of Unilever’s stock by hedge funds dropped from 15% to 5% in three years, which led to reduced fluctuations in the company’s share price.” (Eccles, Ioannou and Serafeim, 2013, p.11-12)

sustainability does not imply an economic sacrifice; rather, it results in significantly higher returns on assets and higher equity value – i.e. more competitive companies overall.²⁴ This advantage is most marked in companies in sectors where brands and reputations matter, where customers are individual consumers, and in natural resource-intensive sectors (Eccles, Ioannou and Serafeim, 2013).

49. The summary of empirical evidence on the impact of CSR on companies is that it has long been inconclusive. In itself, this first result is important, as it does not confirm Friedman's (1970) shareholder model according to which CSR should be detrimental to a firm's performance. More recent work does bring evidence that CSR can benefit corporate financial performance, with observations that span the financial crisis.

50. Such evidence combined with the contribution of these companies to society provides policy-makers with a strong case to push for more company engagement in corporate responsibility.

2.3 How do investors look at corporate responsibility? Do ESG disclosures help?

51. There is growing empirical evidence of the strategic nature of corporate responsibility and of its role in sustaining value creation by companies. Yet there are also signs that the market underestimates this phenomenon. Is there then a role for public policy in ensuring that potential investors can more easily identify companies with a strategic understanding of ESG aspects?

52. The demand-side of this market is increasingly organised. For instance, the UN-backed Principles for Responsible Investment Initiative (PRI) gathers a network of investors totalling USD 34 trillion of assets, and Principle 3 of the PRI requires that these institutional investors "seek appropriate disclosure on ESG issues by the entities in which they invest" (UNPRI, 2014; *The Economist*, 2014).

53. On the supply side, many stock exchanges have now developed sustainability-related indices (e.g. Dow Jones Sustainability Index, FTSE4Good, Stoxx Europe Sustainability Index, the NYSE Euronext Low Carbon 100 Europe Index, the Johannesburg Stock Exchange SRI Index).²⁵ Various screenings are applied, either to exclude certain activities²⁶, focus on sustainability activities, or to identify the best sustainability performance within industry groups.²⁷ The sustainability indices are developed on the basis of specific questionnaires that are meant to go beyond standard disclosures, sometimes complemented by analyses of companies' relations with stakeholders (RobecoSAM, 2014).

54. CSR rating agencies have also flourished in the last decade to provide objective third-party information on the performance of companies in the ESG space. SustainAbility (2014) has undertaken a full review of these agencies under its Rate-the-Raters programme. It argues that rating agencies have mostly been active and in fact competing in data collection, with each using their own methodology. This approach is very different from the task of equity analysts who work from the same data (standard regulatory filings) but compete on its analysis. This indirectly points to the positive role that a standard ESG reporting framework could play, even if the analysis of the produced data will remain essential to

²⁴ The key indicators for high [low] sustainability companies are: a USD 1 investment in the companies' assets in 1993 would have generated USD 7.1 [4.4] in a value-weighted portfolio based on return on assets; looking at book value of equity, a dollar invested would have grown to USD 31.7 [25.7], value-weighted. Further, the portfolio performance of high sustainability companies outperforms low sustainability ones in 14 out of the 18 years of observation (Eccles, Ioannou and Serafeim, 2013).

²⁵ See for instance the Sustainable Stock Exchanges Initiative, www.sseinitiative.org

²⁶ The NYSE Euronext Ethibel Sustainability Index excludes activities in armament, gambling, nuclear energy and tobacco (NYSE Euronext, 2014).

²⁷ See for instance the Dow Jones Sustainability Index or the FTSE4Good ESG ratings.

guide investors and other stakeholders. SustainAbility (2014) also opines that rating cannot be done with a one-size-fits-all approach, especially as what is material to a company's sustainability may not be to another. This also questions the meaning of 'best in class' rankings of ESG performance.

55. Corporate disclosure of ESG activities is essential information for investors, provided they can make effective use of it. In particular, sustainability reports are directed to many different stakeholders, of which investors are just one group. As a result, investors reading ESG disclosures must plough through much more information than what they may feel is necessary to guide investment decisions. Recent surveys of the investment community indicate that ESG reports are not quite as useful to investors as the standard financial information they are accustomed to analysing before recommending an investment.

56. Association of Chartered Certified Accountants conducted a survey to feed into the European discussion on mandatory corporate reporting of non-financial elements (ACCA, 2013a). It confirmed the importance of sustainability reports as primary sources of non-financial information. However, respondents did not generally find an explicit link between non-financial aspects and the business strategy, nor did they consider there to be sufficient information on the financial materiality of the reported information and associated risks and opportunities. Ninety two percent of the surveyed investors found the information provided by companies not sufficiently comparable. Investors and analysts also aspire to more integration of ESG and standard financial information; 84% of the respondents would favour the use of standardised reporting frameworks.

57. Turning to institutional investors, Ernst and Young (2014) finds that they are often unable to identify what issues presented in ESG disclosures could materially impact shareholders returns. Similarly, investors have difficulty connecting non-financial and financial performance and comparing across companies. Nevertheless, non-financial performance is increasingly used to guide investment: for the most part, investors use "non-financial performance as a good benchmark for risk." The most striking result relates to the methods used to assess ESG disclosures: "two-thirds of investors either don't evaluate non-financial disclosures or rely on their own personal ideas about the data. This shows that a framework to aid investors is needed" (Ernst and young, 2014).

58. Radley Yeldar (2013) surveyed 35 analysts and 34 investors, two thirds of which were in the socially responsible investment (SRI) category. The other third (mainstream analysts and investors) nevertheless indicated that they too assess companies' extra-financial information. "Over 80% of our research sample believe that extra-financial information is very relevant or relevant to their investment decision-making or analysis." The survey shows the importance of governance and natural resources aspects for investors and analysts; other 'capitals' are also important but more difficult to compare, especially social aspects. In addition to corporate sustainability reports, the survey participants also mentioned existing reporting guidelines (the GRI Content Index, or the Carbon Disclosure Project) to assess environmental performance in corporate disclosures.²⁸

59. Looking ahead, 80% of participants in the Radley Yeldar survey thought that integrated reporting would bring benefits to their assessments of companies. In yet another survey, 90% of 300 UK and Ireland investors would like to see corporations produce integrated reports in order to have a better understanding of their future performance as well as of the material risks on their business models related to the environment, e.g. climate change (ACCA, 2013b).

60. In a nutshell, there is a wide gap between what investors would like to see in non-financial reports and their current usefulness. At the same time, there is also a general complaint about the 'clutter' of information provided by companies in their various reports.

²⁸ The surveyed participants did not however rely on existing ratings and indices much when assessing companies – one interpretation may be that they apply their own methodology (Radley Yeldar, 2013).

3. REPORTING FOR BETTER & INTEGRATED PERFORMANCE

Fifteen years ago, it might have been enough to tick the boxes on accident frequency, employee satisfaction and heart-warming stories of philanthropic activities. However, this approach no longer cuts it when it comes to showing why sustainability matters and what level of performance an organization has achieved.

WBCSD, Reporting Matters (2013)

But to make proper decisions, investors need standardised, comprehensive information that is consistent over time. So far they are not getting it.

The Economist (2014), on companies opening up about their environmental risks

61. The state of corporate ESG disclosure is multi-faceted, with on the one hand a growing homogenisation via the widespread use of GRI guidelines, and on the other corporate reports that are difficult to compare, provide ever-growing information (sometimes hundreds of pages), and are not always satisfactory as to the quality of information provided. One major critique is a lack of clarity about what is and is not material to the company's business, which limits the usefulness of the report.

62. This should not be considered a niche issue by policy-makers. The links between corporate stability and corporate responsibility appear too strong to be ignored, and on several aspects of ESG, policy is often lagging behind: corporate action in these areas must be encouraged, and that means sending clearer signals to investors about a company's true performance – its integrated performance.

63. The end goal seems relatively clear: concise corporate disclosure that brings together and links financial and ESG performance, both to trigger action in companies that ignore these aspects and may be exposed to risks as a result, and to encourage investments in companies with high integrated performance.

64. We review briefly the proposed avenues for such progress and their pros and cons.

3.1 'One report': towards integrated reporting²⁹

65. The logic of integrated reporting is to bring together financial and ESG aspects of a corporation's performance in a single report, in order to encourage a better integration of ESG components in the company's strategy. It is about driving an internal transformation through a new organisation of corporate disclosure.

66. The purpose of an integrated report is "for companies to explain to providers of financial capital their ability to create value in the near, medium and long term" (Paul Druckman, CEO of the International Integrated Reporting Council, IIRC). As such, it also aims at moving away from the short-termism of capital markets.

²⁹ This title refers to the milestone publication by Robert Eccles and Michael Krzus (2010), titled *One Report: Integrated Reporting for a Sustainable Strategy*. Integrated reporting is sometimes referred to as the 'one-report' approach.

A framework for integrated reporting

67. There is not, at present, a universally agreed framework or template for an integrated report, although IIRC members agreed to an International <IR> Framework in December 2013. There is, however, the beginning of a practice: integrated reports are now mandatory for listed companies in South Africa and France mandates a report combining financial and ESG information for publicly-listed and other companies (Eccles, Cheng and Saltzman, 2010; Institut RSE, 2012). In its survey of its member companies' sustainability reports, WBCSD finds that 8% are integrated reports, 12% combine ESG and financial information, and the rest are 'usual' sustainability reports (WBCSD, 2013).

Box 1. The South African experience with integrated reporting

Hoffman (2012) has reviewed experience to date, following South Africa's introduction of King III (King Code of governance principles for South Africa 2009) which mandates an integrated report for companies listed on the Johannesburg Stock Exchange, on a comply or explain basis. The nature of King III is to have ESG aspects presented as part of the company's strategy. Here are suggestions from South Africa's case:

- IR is data-intensive and requires control systems.
- Inadequate reporting is often a signal to management of a deficiency in processes.
- There are qualitative elements to the materiality assessment (e.g. reputation and credibility), and a well-structured integrated reporting process should help to identify these elements.
- Regarding financial performance, some of the reports explain volatility; the report provides an opportunity to describe exceptional items and their impacts on financial results.
- There can be reluctance in presenting forward-looking information. This information need not be financial, however, and Hoffman rightly points out that users may form their own expectations about future performance, that "can be equally damaging to management if not met".

PriceWaterhouseCoopers (PWC, 2014) gives a mixed picture of performance to date in South Africa, indicating large volumes of data without necessary indication of materiality. Visions are often reported, but actual strategies less so, and drivers of future growth are omitted from three out of four reports.

There is generally a lack of clarity about a Board's and audit committee's role in assuring the content of the report. Risk and risk management are typically included, but at a fairly high level, "without providing real insight" (PWC, 2014). There is no clarity on the alignment of risk management with the company's strategy.

It is of course early to assess the success of integrated reporting, and this should be done on the basis of more than a country's listed companies' experience. In spite of some of the above-mentioned shortcomings, PWC finds that reporting in South Africa is moving in the right direction.

68. The IIRC issued a draft framework for consultation which discussed what an integrated report could cover (IIRC, 2013b). The IIRC *International <IR> Framework* reflected comments received during the consultation (2013d). The framework is based on the following principles, which seek to respond to the criticisms of ESG disclosures to date:

- Strategic focus and orientation;
- Connectivity of information;
- Stakeholder responsiveness;
- Materiality and conciseness;
- Reliability and completeness;
- Consistency and comparability.

69. The framework then builds on three fundamental concepts: capitals (financial, manufactured, intellectual, human, social and relationship, and natural); the business model; and the value creation of the company. While IR does not aim at expressing the value of a company's capitals in a common metric (e.g. monetising the company's impact on society beyond its direct value added), the report should present trade-offs and opportunities when using various capitals for an enhanced financial performance. The framework would expose a company whose financial performance involves the destruction of one of its capitals, and favour those organisations that manage to create financial value while preserving or enhancing their capitals.

70. Some concerns were expressed by the respondents to the IIRC draft framework which indicate the complexity of this new approach. Here are some of the less technical, but potentially more strategic ones:³⁰

- Can competitiveness concerns be used to avoid disclosing data on material matters?
- Similarly, how to approach the question of a business model's resilience without divulging commercially-sensitive information?
- How does the IR relate to existing reports, and how to make the transition in a domestic context where ESG reporting legislation is in place?
- Are the various capitals to be monetised or quantified?
- How comfortable are companies with reporting on their future actions? Further: what form of assurance can third-party auditors provide on such information? These are potentially important questions for companies' and auditors' legal departments.
- Should companies disclose how they determine material matters? How to identify and prioritise materiality elements when addressing a range of stakeholders with different interests in a company's activities?

71. A broader issue is whether IR will enhance the comparability of companies' reports. The IIRC stresses that its proposed framework is principles- and not rules-based, and that a balance can be reached between the flexibility needed to accommodate differing company circumstances and some degree of comparability (IIRC, 2013d).³¹

72. Some time will be needed before integrated reports are easily comparable across companies. Existing guidelines (e.g. GRI) may accompany this new form of reporting, and contribute to comparability, as they have for ESG reports to date.

73. On the bright side, in an effort to move away from the clutter of multi-dimensional performance indicators and activity reporting, there is a call to focus reports on material risks and opportunities, in IR but also in the latest version of the GRI guidelines (GRI, 2013a). The effort of the US-based Sustainability Accounting Standards Board to develop sector-specific material key performance indicators should facilitate comparability of corporate reports, at least in this area.

³⁰ These concerns were addressed by the IIRC in the International <IR> Framework (IIRC, 2013d).

³¹ Bray and Chapman (2012) indicate that 'in contrast with a compliance-based reporting [...] there cannot be a template for the integrated report. It has to be built around the business model 'of the preparer'.

Going forward with integrated reporting

74. In the accounting and reporting field, the idea of a single integrated report is gathering momentum. ACCA's recent survey shows that 90% of investors would like to see financial and non-financial elements of a company combined in an integrated reporting format (ACCA, 2013b).

75. Even if the radical change required by IR may be daunting, the alternative of ever-growing stand-alone ESG reports that lack a link to the company's business model and strategy does not seem attractive. Nor does it align with the recognition that companies with strong ESG records are better equipped to manage risk and sustain value creation, which should attract policy-makers' attention.

3.2 Monetising corporations' externalities

76. In the spirit of applying the recommendations of the economic discipline at company level, the monetisation of companies' ESG costs and benefits is starting to catch the attention of an increasing number of companies. A recent study sponsored by the Natural Capital Coalition (formerly TEEB for Business Coalition) attempted a costing of the top 100 externalities of business. Their estimate of unpriced natural costs from business activities is an impressive USD 7.4 trillion annually, equivalent to 13% of the global economic output in 2009 (Trucost, 2013).³²

77. PUMA pioneered the first wide-ranging environmental profit and loss (EP&L) evaluation, looking beyond its direct impacts to its full value chain (PUMA, 2011). Beyond raising the internal and external awareness of this issue, the bottom line figure (EUR 145 million) and the underlying detailed analysis helped the company identify best practice inside its value chain and more resource-efficient practices, and provided important sustainability information to its stakeholders. PUMA's then chairman, Jochen Zeitz, has called for an agreement on a standardised way to calculate the environmental impact of companies, a means to improve the sustainability of products (Environmental Finance, 2012).

78. The monetisation of externalities obviously does not *directly* impact on a company's financial performance in the way a set of taxes paid on the same externalities would. At this pioneering stage, the EP&L can in fact deliver the opposite outcome through a better use of the company's capitals; after a careful identification and quantification of its impacts, a company can simply save money through more efficient resource use. Pioneers in this area are likely to establish themselves as better corporate citizens than companies which keep such information under the rug. This may reflect well on the company's value in the future, assuming that its disclosure reveals an improving EP&L figure.

79. Other capitals are the object of research towards their monetisation, including by the B-Team and WBCSD on social capital, with a view to producing a methodology for a social profit & loss account. The goals of an SP&L are to manage risk, inform management, inform the strategy through valuation, to inform public policy and set a standard for such reporting (Dublin, 2014).

80. Looking to the future, the monetisation of capitals by corporations raises two main questions:

- Can this become a common feature of ESG disclosures, through stakeholders or peer pressure? There is a clear value in disclosing this information, e.g. to answer to consumers' preferences for environmentally-friendly products, but this objective may also be met with environmental impact labelling. The attractiveness of monetisation is that it uses a single metric that is easily understandable by consumers (and senior management; the EP&L has proved very useful in raising internal awareness precisely because it is communicated in

³² "No high impact region-sectors generate sufficient profit to cover their environmental impacts" (Trucost, 2013).

monetary terms, a language CEOs are comfortable with); stakeholders who seek information on specific impacts could turn to the detailed EP&L.

- Is the monetisation of environmental externalities most useful as an internal management tool to assess risks and reduce costs? PUMA made the strategic choice to make its EP&L public, and uses the tool to guide internal decisions. It is common knowledge that some oil and gas companies apply a shadow price to CO₂ emissions when assessing investments – they do not, however, present publicly the total cost of the generated externalities.³³
- Monetisation obviously depends on the quality of the data used in the assessment. How robust and reliable are these data? Further, could common datasets be established for key parameters to progress towards comparability?

3.3 Mandatory ESG reporting?

81. We discussed previously possible avenues for the development of better corporate reporting to reflect corporations' full impact on society, and to promote better overall performance. Such an outcome would obviously represent a contribution to the public good, through more robust value creation and less environmental degradation. It may therefore be legitimate for governments to mandate such an approach, at least for companies that have a marked impact on society. A few countries have taken steps in this direction. The European Union is now moving forward with mandatory extra-financial reporting for companies above a certain size. However, the EU allows for ESG disclosure to be published separately from financial data and does not include meaningful assurance measures on ESG.

82. Ioannou and Serafeim (2012) bring empirical evidence of the effects of mandatory ESG reporting on companies' behaviour, based on a cross-country study that records the enactment of specific, mandatory ESG reporting measures.³⁴ Looking at companies within countries, and more specifically those that did not disclose ESG elements before it became mandatory, they find significant decline in energy, water, and waste, and a growth in employee training after the introduction of mandatory CSR – further evidence that the information collected for compliance purposes triggered internal behavioural changes toward more sustainability and social improvement.³⁵

83. One argument against mandatory reporting is that it delineates strictly what must be presented: this may actually narrow the scope of interest by a company's Board that will view ESG reporting as another compliance obligation and not necessarily capture the internal management upsides. It may also be seized as an opportunity to portray business-as-usual as genuine efforts in ESG. To be helpful to investors and other stakeholders, mandatory reporting would need to be accompanied with more scrutiny on the materiality of companies' impacts on society, and on the comparability of disclosures, also to measure progress over time. On the other hand, some flexibility in what companies need to report allows companies to innovate in this field, finding new ways of tracking performance.

³³ There is no clear evidence that this practice has had an impact on the profile of these companies' investment, however.

³⁴ "The first country to adopt a MCSR law in the sample is Finland, in 1997. Other countries that adopted a MCSR law are: Australia, Austria, Canada, China, Denmark, France, Germany, Greece, Indonesia, Italy, Malaysia, Netherlands, Norway, Portugal, Sweden and the United Kingdom." (Ioannou and Serafeim, 2012).

³⁵ On mandatory reporting, PWC (2011) finds that "regulation does, however, tend to increase everyone's attention on certain areas, and this, in time, drives real improvements in the quality and coherence of key information reported."

CONCLUSION

84. A growing number of companies publish ESG disclosures. For some of these companies, ESG activities reflect or have led to innovations, better risk management, new business opportunities and an enhanced capacity to create value in the future. Such practice should be encouraged by society and investors alike. And yet current ESG disclosures do not always allow stakeholders to identify information that matters to them, nor to compare companies among themselves – even if much harmonisation has taken place thanks to sustained efforts in this area.

85. The mandating of financial reporting and the creation of accounting standards was probably the single most important driver of the development of capital markets. Such reporting is being improved constantly to keep up with innovations in financial markets and ensure adequate transparency.

86. Reporting could see important evolutions in ESG disclosure in the coming years. There are pressures from a range of stakeholders to extend ESG disclosure to companies that so far do not wish to report on their impacts on society and the environment. The EU is about to mandate non-financial disclosures for companies above a certain size, while other regions follow a voluntary path. There are also pressures to generate corporate reports that reflect integrated performance, to eventually allow investors to make choices that better reflect socio-economic and environmental impacts. This evolution is not without significant technical challenges, but, if successful, it could create an additional, powerful lever to move companies and societies toward a more sustainable path.

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ANNEX A – A SELECTION OF INSTRUMENTS FOR CORPORATE RESPONSIBILITY

Focus	Government sponsored or supported	Industry sponsored	Partnership sponsored	Labour or NGO sponsored
General, including aspirational instruments	<ul style="list-style-type: none"> • OECD MNE Guidelines • UN Global Compact 	<ul style="list-style-type: none"> • Caux Round Table Principles for Business • Global Sullivan Principles • International Chamber of Commerce (ICC) Business Charter for Sustainable Development • ICC Business in society: making a positive and responsible contribution 	<ul style="list-style-type: none"> • Earth Charter 	
Corporate Disclosure	<ul style="list-style-type: none"> • OECD Principles of Corporate Governance • OECD MNE Guidelines • UN Global Compact 		<ul style="list-style-type: none"> • Global Reporting Initiative (GRI) Sustainability Reporting Guidelines 	
Labour	<ul style="list-style-type: none"> • ILO MNE Declaration • ILO Declaration of Fundamental Principles and Rights at Work • OECD MNE Guidelines • UN Global Compact 		<ul style="list-style-type: none"> • Ethical Trading Initiative Base Code and Principles (UK) • Social Accountability SAI 8000 • Fair Labor Association Workplace Code of Conduct 	<ul style="list-style-type: none"> • ICFTU Basic Code of Labour and Practice
Human Rights	<ul style="list-style-type: none"> • UN Global Compact • OECD MNE Guidelines • ILO MNE Declaration 			<ul style="list-style-type: none"> • Amnesty International Human Rights Principles for Companies
Environment	<ul style="list-style-type: none"> • UN Global Compact 		<ul style="list-style-type: none"> • ISO 14000 series environmental management standards • Eco-Management and Audit Scheme (EMAS) • Ceres Principles 	
Bribery	<ul style="list-style-type: none"> • OECD Convention on Combating Bribery • UN Convention against Corruption • OECD MNE Guidelines • UN Global Compact 	<ul style="list-style-type: none"> • ICC Rules of Conduct to Combat Extortion and Bribery 		<ul style="list-style-type: none"> • Transparency International Business Principles for Countering Bribery
Risk	<ul style="list-style-type: none"> • OECD Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones • UN Global Compact Business Guide for Conflict Impact Assessment and Risk Management 			
Quality management, assurance/verification			<ul style="list-style-type: none"> • ISO 9000 series quality management 	

		standards	
		<ul style="list-style-type: none"> AccountAbility AA1000 Assurance Standard 	
Supply Chain Codes	<ul style="list-style-type: none"> ICC Guidance on Supply Chain Responsibility 		
Accreditation, certification, labelling codes		<ul style="list-style-type: none"> ISO 14020 series standards on environmental labels and declarations ISEAL Code of Good Practice for Setting Social and Environmental Standards 	
Consumer	<ul style="list-style-type: none"> UN Guidelines for Consumer Protection OECD MNE Guidelines WHO Ethical Criteria for Medical Drug Promotion OECD Guidelines for Consumer Protection in the Context of Electronic Commerce 	<ul style="list-style-type: none"> ISO 10000 series on customer satisfaction 	
Reporting		<ul style="list-style-type: none"> GRI Sustainability Reporting Guidelines 	
Comprehensive (e.g. "social responsibility" "sustainability")	<ul style="list-style-type: none"> World Bank Group Performance Standards on Social and Environmental Sustainability 	<ul style="list-style-type: none"> GRI Guidelines ISO 26000 Standard (under development) 	
Stakeholder engagement		<ul style="list-style-type: none"> AA1000 Stakeholder Engagement Standard 	
Sectoral			
Advertising	<ul style="list-style-type: none"> ICC International Codes of Marketing and Advertising Practice 		
Agriculture		<ul style="list-style-type: none"> International Federation of Organic Agriculture Movements (IFOAM) Principles and Norms Common Code for the Coffee Community 	
Apparel		<ul style="list-style-type: none"> GRI Sector Supplement for Apparel 	
Chemicals	<ul style="list-style-type: none"> Responsible Care program 		
Energy		<ul style="list-style-type: none"> WRI/WBCSD Greenhouse Gas Protocol ISO 14064-65 standards on measuring greenhouse emissions GRI Sector Supplement for 	<ul style="list-style-type: none"> Greenhouse Gas (GHG) Production Certification Standard

Extractives	<ul style="list-style-type: none"> • Extractives Industries Transparency Initiative (EITI) Principles and Criteria • Voluntary Principles on Security and Human Rights • Kimberley Process Certification Scheme • Collaborative Group on Artisanal and Small-Scale Mining (CASM) best practices guidance. 	<ul style="list-style-type: none"> • International Mining and Metals Council (ICMM) Principles for Sustainable Development Performance • International Cyanide Management Code 	<p>Electric Utilities</p> <ul style="list-style-type: none"> • GRI Sector Supplement for Mining and Metals • Initiative for Responsible Mining Assurance (IRMA) (principles under development) • Diamond Development Initiative (DDI) (standards under development)
Investment	<ul style="list-style-type: none"> • International Finance Corporation (IFC) Performance Standards • Principles for Responsible Investment 	<ul style="list-style-type: none"> • Equator Principles 	
Electrical		<ul style="list-style-type: none"> • Electronic Industry Code of Conduct (EICC) 	
Forestry		<ul style="list-style-type: none"> • Confederation of European Paper Industries (CEPI) Code of Conduct 	<ul style="list-style-type: none"> • Forest Stewardship Council (FSC) Principles and Criteria • ISO 14061: 1998 information to assist forestry organisations in the use of environmental management system standards • ISO 14001 and ISO 14004
Fisheries			<ul style="list-style-type: none"> • Marine Stewardship Council (MSC) Environmental Standard
Oil and Gas		<ul style="list-style-type: none"> • Petroleum Industry (IPIECA) Guidelines for Reporting Greenhouse Gas Emissions 	
Toys		<ul style="list-style-type: none"> • International Council of Toy Industries (ICTI) CARE Initiative 	

Source: Annual Report on the OECD Guidelines for Multinational Enterprises 2008 (OECD, 2009).