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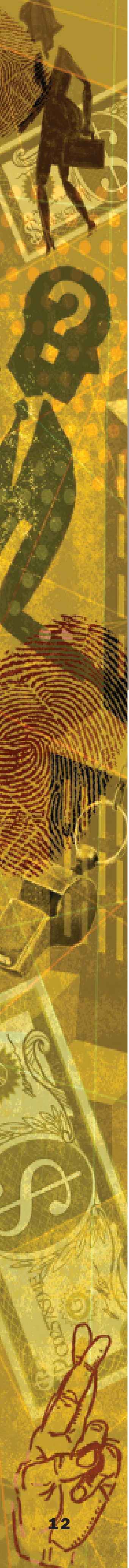

Should Sustainability Reporting Be Integrated?

Global thought leaders on the subject of sustainability are proposing a new organizational reporting structure that links current financial performance with the social, environmental, and economic context within which the organization operates. This initiative is unlikely to find traction in the U.S. today.

The quantity of financial information that organizations report to their shareowners, regulators, and the general public has expanded greatly in the last few years. Although it isn't required, many corporations also publish reports of nonfinancial information concerning their social, environmental, and other sustainable activities. The number of companies issuing such reports continues to grow rapidly. Almost all companies issue their sustainability reports separately from their financial reports, whose contents are mandated by government or regulatory agencies.

Global thought leaders on the subject of sustainability are addressing the challenge of providing more useful information in a clearer, more concise, and user-friendly format. The latest example is the discussion paper titled *Towards Integrated Reporting—Communicating Value in the 21st Century*, which was published in September 2011 by the International Integrated Reporting Committee (IIRC). The IIRC is composed of an international cross-section of leaders from the corporate, investment, accounting, securities, regulatory, academic, and standards-setting sectors as well as civil society.

According to Sir Michael Peat, chair of the IIRC, "All matters which are important in assessing an organization's performance and position, past and prospective, need to be reported, but not by making annual reports ever longer and more complex. The information needs to be provided clearly and concisely with the connections between financial, environmental, and social impacts demonstrated."

The trend toward greater focus on an organization's responsibility to act sustainably and to voluntarily report relevant performance information began outside the United States. For example, actions to stem global warming are far more advanced in the European Union than elsewhere. In 2001, France became the first country to legally require reporting of sustainability information. Concerning reporting, CorporateRegister.com logged sustainability reports from 580 U.K. companies in 2010, an increase of 60% from 2006. In comparison, the 641 U.S. reports from 2010 represented an increase of 136% in the same period.

Reflecting the influence of various global nongovernmental organizations, sustainability reports have unique titles and cover varying areas of corporate responsibility. The world's largest developer of voluntary standards, the International Organization for Standardization (ISO), published *ISO Standard 26000* in November 2010 to provide guidance on social responsibility. Over the years, considerable effort has also been expended to develop standards for the content of reports on sustainability performance.

The Global Reporting Initiative (GRI) developed the Sustainability Reporting Framework, which is generally considered the most widely used framework for reporting performance on human rights, labor, environmental, anticorruption, and other corporate citizenship issues. Participants in the development process were drawn from global business, civil society, labor, academic, and professional institutions. Because the process involves a multiple-stakeholder and consensus-seeking approach, their use is voluntary in most countries, and their application is subject to interpretation by an organization's management.

The Sustainability Reporting Framework consists of the Sustainability Reporting Guidelines, Sector Supplements, and the Technical Protocol—Applying the Report Content Principles. Included within the Framework are performance indicators and management disclosures that organizations can utilize voluntarily, flexibly, and incrementally, enabling them to be transparent about their performance in key sustainability areas.

The Sustainability Reporting Guidelines, which are part of the Framework, were first issued in 2000, with the current version, G3, published in 2006. Version G3.1 contains expanded guidance on local community impacts, human rights, and gender. The comment period is currently open for G4, the next revision of the Guidelines, with the expected publication date in 2013.

The Guidelines contain principles for both defining report content as well as for ensuring report quality. Content-based principles are: Materiality—reflecting the organization's significant economic, environmental, and social impacts; Stakeholder Inclusiveness—explaining the organization's response to reasonable stakeholder interests and expectations; Sustainability Content—presenting performance within the wider context of sustainability; and Completeness—coverage should enable performance assessment.

Quality-based principles contained in the Guidelines are: Balance—the presentation should include both positives and negatives; Comparability—issues should be selected, compiled, and reported consistently; Accuracy—information should be accurate and detailed to enable performance assessment; Timeliness—information should enable informed decisions; Clarity—information should be understandable and accessible to users; Reliability—information should be gathered, recorded, compiled, analyzed, and disclosed in a way that could be subject to examination.

Standard disclosures set forth in the Guidelines include three aspects: profile, performance indicators, and management approach. The profile section includes organizational strategy and analysis, its structure, report parameters, governance commitments, and engagement. Performance indicators include environmental, human rights, labor practices and decent work, society, product responsibility, and economic. The management approach section is designed to address how the organization manages the sustainability topics associated with its risks and opportunities.

In September 2011, ISO and GRI signed a memorandum of understanding to increase their cooperation in guidance development. GRI Chief Executive Ernst Ligteringen stated, "GRI's mission is to make sustainability reporting standard practice, and this new partnership with ISO will help more businesses around the world to improve their sustainability management and reporting practices."

Improving Reliability of Reports

One of the criticisms leveled against sustainability reporting in general is that information is self-gathered and self-reported. Few reports contain independent assurance. Because there are no global mandates for sustainability reporting, management can be accused of providing only favorable information about those areas where the company chooses to follow sustainability guidelines, leading to the charge of "greenwashing."

GRI classifies the quality of sustainability reports based on its Framework as Application Level A, B or C, depending on the number and set of Guidelines disclosures used by the reporting organization. Organizations can add "+" to any of the three levels by obtaining an Application Level Check from GRI. This certifies that the GRI Content Index in the report demonstrates a valid representation of required disclosures. Application Levels don't provide an opinion on the sustainability performance of the reporter nor the quality of the information in the report.

In the wake of complaints that some existing social and environmental reports may contain unsupported assertions about an organization's public relations initiatives, London-based consultancy Verdantix conducted a study titled *Green Quadrant Sustainability Assurance Providers* that examined what firms are doing to increase the credibility of sustainability reporting. The study states that "companies are investing more in (independent) sustainability assurance." It found that "sustainability risks tied to corporate reputation and compliance are on the increase," leading to "an increasing realization that sustainability is a competitive advantage [that] will drive investor interest in [a] firm's sustainable performance." The study concludes that this will create demand for "financial grade sustainability management information." Time will tell whether these assertions are correct.

U.S. Efforts

Several U.S. initiatives to improve the content and quality of reported performance information have been undertaken along with the global efforts described above. In June 2011, the Public Company Accounting Oversight Board (PCAOB) issued a concept release to discuss several alternatives for changing the auditor's reporting model that could increase the model's transparency and relevance to financial statement users while not compromising audit quality. Among the alternatives suggested in the release is the possibility of highlighting the most significant matters in the financial statements and identifying where these matters are disclosed in the financial statements.

The Center for Audit Quality (CAQ), which is affiliated with the American Institute of CPAs (AICPA), published on September 28, 2011, its *Summary Report of Roundtable Discussion Series on Changing the Role of the Auditor to Meet Investors' Needs.* The areas most commonly identified as appropriate for association by independent auditors included disclosures of the company's process for assessing risk and developing financial assumptions and estimates; the company's critical judgments and accounting estimates; and the risk factors disclosed in the annual report.

The IIRC concept release contains a number of sound arguments that support development of a new integrated reporting framework, including combining the current disconnected strands of reporting into a more coherent and integrated whole. That will enable users to more effectively evaluate an organization's ability to create value in the present and future. The objective of integrated reporting is to demonstrate an organization's use of and dependence on different types of resources, whether they are financial, manufactured, human, intellectual, natural, or social. Consequently, users of performance information should be better able to assess long-term viability and more effectively allocate scarce resources.

Despite the asserted benefits to users, it seems highly unlikely that current U.S. lawmakers would require organizations to be saddled with huge new regulatory compliance costs to gather, analyze, disclose, and assume the burden of providing assurance on a vast new set of information. Without such a statutory mandate, the global integrated reporting initiative is likely to find little traction in the U.S. **SF**

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