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# The Future of Sustainability Reporting

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## MAIN POINTS

- The concept of sustainability reporting (SR) is now almost twenty years old. In the run-up to the 2012 Rio+20 Conference, the time has come to review its objectives and achievements, and to decide whether action is needed to improve its effectiveness and uptake.
- The underlying proposition of SR is that reporting on economic, social and environmental performance is vital if governments, business and the wider community are to understand and improve their contribution to a Green Economy and sustainable development.
- In this sense, SR was conceived as an essential complement to financial reporting. SR provides transparency on data on organizational performance directly relevant to sustainable development that had not previously been measured, used or made public.
- This first phase of sustainability reporting – SR 1.0 – has arguably passed the ‘proof of concept’ test. In what amounts to a disclosure revolution, many of the world’s largest public companies now voluntarily report on their sustainability policies and contributions.
- Sustainability information is being used to better assess financial risk, to improve relations with stakeholders (including employees), to set corporate strategy, and to develop new products and services. Increasingly, SR is seen as an important element of good governance.
- However, SR faces a number of serious challenges. It is still not a common practice among all companies, public agencies and civil society bodies. There are also questions about the accuracy and completeness of data reported, and its relevance to financial performance.
- Against this background, the question needs to be asked whether further progress towards a Green Economy and sustainable development can be made without improving both the quantity and quality of sustainability reporting. If not, how should this be done?
- Any discussion of the next phase of sustainability reporting – SR 2.0 – involves the Global Reporting Initiative (GRI), the most widely used SR framework. Options include taking GRI to a new level, complementing it, or replacing it with something more effective.
- The shape of SR 2.0 remains to be defined. Three things, however, already seem clear.
- Stakeholders will continue to play a decisive role. What they do, or do not do now, will play a large role in determining the future frameworks and practices of SR.
  - Given GRI’s size and first-mover momentum, it is likely to remain at the centre of SR activity. To scale up, however, it will need to address a range of issues.
  - Universal SR by all large companies and organizations is far from being a normal practice. For this to occur, ways need to be found to further mobilize and incentivize reporting.
- The practice of SR is likely to become ever more confrontational, in the sense that it is likely to reveal the extent of the gap between sustainability policy aspirations (e.g. carbon emission reduction) and actual practice. This information remains crucial, however, if faster progress is to be made towards sustainable development.

## BACKGROUND

In contrast to financial reporting, the history of sustainability reporting (SR) is comparatively recent. The proposition that organizations, and business organizations in particular, should supplement their financial accounting with accounting on their environmental, social and other 'non-financial' performance – or 'sustainability reporting' – first emerged in the 1990s. At the time of the 1992 UN Conference on Environment and Development (UNCED), relatively few companies engaged in SR in any form. Responding to increasing media attention to environmental problems, most reports focused on environmental policies and performance.

While calls for SR initially stemmed mainly from advocacy groups and investors, as well as some business leaders, governments played a historic role in formally recognizing the importance of this new dimension of reporting. It is often overlooked that environmental reporting was specifically recognized by the world's governments in Agenda 21, one of the main outcomes of the UNCED conference. There it was agreed that *'(b)usiness and industry, including transnational corporations, should be encouraged: (a) to report annually on their environmental records, as well as on their use of energy and natural resources'*.

In the decade between UNCED and the 2002 World Summit on Sustainable Development (WSSD), a number of initiatives were undertaken to explore and advance SR. Among these the most notable was the Global Reporting Initiative (GRI). Launched first in 1997 as a pilot project, it was a multi-stakeholder initiative to design a framework that could make reporting on an organization's economic, social and environmental performance as routine and accepted as financial reporting. When GRI was officially launched in April 2002, around two hundred pioneering companies were using the GRI framework to report annually on their sustainable development policies and practices.

By the time of the WSSD, the concept had sufficiently matured for governments to formally recognize both SR and the role of GRI. In the Johannesburg Plan of Implementation, they noted that enhancing corporate environmental and social responsibility and accountability could be achieved by

*actions at all levels to: (a) encourage industry to improve social and environmental performance through voluntary initiatives, including environmental management systems, codes of conduct, certification and public reporting on environmental and social issues, taking into account such initiatives as the ISO standards and Global Reporting Initiative guidelines on sustainability reporting....*

It should be noted that the decision to pursue a voluntary approach to SR at this point was not universally supported. There were many in the non-government organization (NGO) community who argued that effective corporate transparency and accountability could only be achieved through binding national legislation based on an international treaty. This argument did not prevail for a number of reasons, including the fact that financial reporting, while not voluntary, was largely based on standards developed by professional associations, and not legislation. The decision was made, instead, to explore the potential and flexibility of voluntary SR reporting, recognizing that it was still a very new field, where agreement still needed to be forged on the relevant issues and metrics.

At the start of 2012, however, it is clear that the concept of SR has become firmly lodged as a desirable and increasingly mainstream practice in key sectors worldwide. The underlying proposition of SR is that progress towards a Green Economy and sustainable development cannot be made unless information is disclosed on the economic, social and environmental impacts and performance of business and other organizations. It appears to be widely recognized that, together with financial information, sustainability information is essential if regulators, companies, investors and the wider community are to be able to measure and understand an organization's contributions to sustainable development.

- *Government:* Against this background, many national governments have developed corporate social responsibility (CSR) policies that encourage SR. A significant number, including the European Union, have introduced corporate accounting policies that

encourage reporting of material environmental and social information. A handful of countries (including Denmark and Sweden) have gone further and formally mandated SR for certain large companies. A small number of public agencies have also begun SR.

- *Intergovernmental standards:* A number of international initiatives promote disclosure on sustainability issues. The world's largest corporate responsibility initiative, the UN Global Compact, requires its over 6,000 business participants to issue regular 'Communications on Progress' reporting action taken to promote its ten human rights, labour, environmental and anti-corruption principles. The 2011 revised OECD Guidelines also reiterate the importance of disclosure on environmental, social and governance issues. Both of these specifically reference the GRI as a useful disclosure framework.
- *Business:* More tellingly, thousands of (mainly large, listed) business organizations around the world now issue SR reports on a regular basis. Recent research suggests that 95% of the Fortune Global 250 companies disclose sustainability data.<sup>1</sup> Most of them use the GRI framework. Many more use SR frameworks informally. Sustainability data are being collected and used internally and along supply chains to reduce risk, drive performance improvements and develop new business models. Sustainability data are now also routinely distributed to financial analysts by market information providers such as Bloomberg and Thomson Reuters.
- *Civil society:* NGOs, academic institutions and other organizations continue to play an active role in initiating and refining SR frameworks. Some also disclose information on environmental and social policies and performance. In 2010, NGOs and their stakeholders developed and published 'sector specific' SR guidelines using the GRI framework.
- *International standards:* The ISO 26000 Standard 'Guidance on Social Responsibility', published on 1 November 2010 after a six-year multi-stakeholder process, notes that an organization '*should, at appropriate intervals, report about its performance on social responsibility to the stakeholders affected*'. As defined in the Standard, social responsibility explicitly includes addressing social and environmental issues.
- *Improved reporting frameworks:* In recognition of the fact that SR is a relatively new phenomenon, and there is still much to be learned, GRI and other SR frameworks are working on refinements to reflect user and stakeholder experience. GRI has begun work on the fourth generation of its Sustainability Reporting Guidelines (known as 'G4'), with a completion target of 2013. In 2010, a number of organizations, including GRI, launched a process to develop an 'Integrated Reporting' framework, also with a target date of 2013.

The most recent evidence of the maturation of SR is set out in the European Commission's Communication on Corporate Social Responsibility, published on 25 October 2011. In a section entitled 'Improving company disclosure of social and environmental information', the Communication notes that *(d)isclosure of social and environmental information, including climate-related information, can facilitate engagement with stakeholders and the identification of material sustainability risks. It is also an important element of accountability and can contribute to building public trust in enterprises.* The Communication adds that an estimated 2,500 European companies currently publish CSR or sustainability reports, and that *'there are a number of international frameworks for the disclosure of social and environmental information, including the Global Reporting Initiative'*. Looking ahead, it adds that *'to ensure a level playing field, as announced in the Single Market Act the Commission will present a legislative proposal on the transparency of the social and environmental information provided by companies in all sectors'*. It concludes by encouraging all organizations, including civil society organizations and public authorities, to *'take steps to improve disclosure of their own social and environmental performance'*.

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<sup>1</sup> KPMG International Survey of Corporate Responsibility Reporting 2011.

## THE CURRENT STATE OF SUSTAINABILITY REPORTING – FRAMEWORKS

Reflecting the still emerging understanding of sustainable development and related reporting, a range of frameworks has been developed for measuring and disclosing sustainability performance.

### Global Reporting Initiative (GRI)

As noted above, the GRI has emerged as the preferred international framework for reporting on the 'triple bottom line' – meaning the three pillars of sustainable development, economic, social and environmental performance. Analysis of sustainability reports shows that the vast majority of companies issuing reports use the GRI, and that its popularity has grown steadily over its short lifetime. Some figures illustrate the point. In 2010, over 1,800 companies publicly declared their use of the GRI framework. The same year, 95% of the companies on the Dow Jones Sustainability Index (DJSI) Super Sector Leaders list used the GRI. Fully 78% of companies listed on the FTSE4Good Global 100 and 70% of companies on the 'Global 100 Most Sustainable Corporations' also used the GRI framework to disclose sustainability data. Five years earlier, these figures were around 20 percentage points lower.

In addition to being the most detailed framework enabling organizations to report on all three sustainable development pillars, GRI's relative success can be attributed to a number of factors. These include:

- *First-mover advantage:* GRI was the first global SR framework to be developed and piloted.
- *Stakeholder development:* GRI was developed through a multi-stakeholder negotiating process involving thousands of representatives of business, accounting, academic, labour and advocacy organizations from around the world, as well as from governmental bodies.
- *Sector sensitivity:* In addition to GRI's generic Sustainability Reporting Guidelines, it has developed a number of 'Sector Supplements', offering sector-specific sustainability guidance and indicators.
- *Continuous improvement:* GRI has a 'learn by doing' approach. Users start by reporting on the issues that are most relevant, and extend reporting as capacity and need dictate. The GRI Guidelines are reviewed and updated regularly to reflect user experience.
- *Materiality-driven approach:* GRI's framework encourages users to identify the issues that are most material, both to the reporter and to its stakeholders. It also offers indicators that can be used to report on the sustainability issues identified. In this regard, GRI is also compatible with materiality-driven approaches, such as the AccountAbility AA 1000 Assurance Standard.
- *Compatibility:* the GRI framework is complementary to the most widely used global corporate responsibility guidance frameworks, such as the UN Global Compact, the OECD Guidelines for Multinational Enterprises, and the ISO 26000 Guidance Standard on Social Responsibility.

### Company-specific reporting

Some companies choose to develop their own reporting frameworks, including sustainability metrics and indicators. This provides them with the flexibility to focus on industry-specific issues and metrics and report those that they judge most relevant. In this context, the development of software-based 'dashboard management' approaches, which seek to map performance on key indicators, including sustainability, is noteworthy. Intra-company facility-level reporting is one example of an SR reporting practice that companies use to improve sustainability performance. While this approach is commonly practised, and can be compatible with a GRI-based framework, it

appears to have become less popular as more companies seek the credibility and convenience of using recognized SR standards and frameworks, such as GRI.

### **Product-specific reporting**

Product labelling has long been an accepted way of drawing attention to the relative sustainability merits of a particular product. Targeting the potential of consumer power, a number of SR initiatives have emerged which seek to communicate the sustainability footprint of individual products. Using modern software scanning techniques, initiatives such as the 'GoodGuide' enable shoppers to use smart phones in some areas to check on the social and environmental impact of products. Product sustainability reporting has the advantage of providing very specific information on social or environmental issues, and has enjoyed a degree of consumer success (e.g. 'fair trade' or Forest Stewardship Council (FSC) branded products). Its main disadvantage, however, is that it has not yet developed to the point where all three dimensions of sustainability –'people, planet, profit' – are reflected at the organizational level.

### **Issue-specific reporting**

Concerns about climate change have driven demand for both standards for reporting emissions data (such as the World Resources Institute/World Business Council for Sustainable Development Greenhouse Gas Protocol) and frameworks for reporting on carbon emissions (such as the Carbon Disclosure Project (CDP) framework). The CDP, an initiative driven by investor groups with \$71 trillion in assets, has over 3,000 organizations across 60 countries around the world now routinely measuring and disclosing their greenhouse gas emissions, water management and climate change strategies using its frameworks. Other SR initiatives address issues such as payments made by multinational companies to host governments under resource extraction agreements.

### **Sector-specific reporting**

In a number of sectors, companies have worked together to develop standards and reporting protocols to address what they see as the main sustainability issues facing their specific business. The advantage of such an approach is that the challenges facing one sector (e.g. electronics) can be very different from those facing another (e.g. retail), with the need for different indicators and metrics. But no matter how robust they are, industry-developed frameworks can fail to command the same level of recognition of stakeholder-developed frameworks. This may be one of the reasons why sectors such as mining, and oil and gas, have developed (or are developing) reporting guidelines using the GRI framework, having first developed their own approaches. As noted previously, GRI 'sector supplements' are designed to complement the generic GRI sustainability indicators, and exist for other sectors, including airport operators, financial services, construction and real estate, and NGOs.

### **National sustainability reporting**

As noted above, various national incentives and encouragements are given for SR. These include national regulations and policies, as well as stock exchange listing requirements and recommendations. Even where these require SR reporting, they usually leave the choice of the reporting framework to the reporter. One exception is Sweden, where state-owned companies are required to report, but are directed to use the GRI. While no comprehensive 'triple-bottom-line' national SR frameworks have yet been developed, the concept is under consideration, reflecting an interest in an SR approach that reflects distinctive sustainability, cultural and language issues. To test the practicability of such approaches, GRI has launched a pilot project for Brazil on a possible national annex to the GRI Sustainability Reporting Guidelines.

### **Integrated reporting**

Another candidate for consideration is the 'integrated' or 'single' financial and sustainability report. Having developed separately from financial reporting, SR most often takes the form of a separate report, which is either published independently from the organization's financial accounts or as a

separate chapter of an annual report. A multi-stakeholder initiative launched in 2010 by the International Integrated Reporting Committee (IIRC) is currently seeking to develop a framework that would combine financial, environmental, social and governance data in one report. A draft Discussion Paper was opened for public comment on 14 September 2011, with the target of developing an operational framework by 2013. In parallel, over 60 companies are already engaged in a pilot programme to test the concept. Proponents argue that a single report will help ensure that managers, investors and other stakeholders better put a financial value on – and link to – environmental, social and governance (ESG) issues. While questions such as its likely scope, effectiveness and uptake must remain speculative until a draft framework emerges, the initiative is another sign of the increasingly serious attention being given to the implications of sustainable development for the future operations of business organizations in particular.

### **Software reporting tools**

A number of public and proprietary SR information technology tools have been developed and are in use. These can be from software-based programmes that help reporters collect company data on key sustainability indicators for use with existing reporting frameworks such as GRI, or that offer their own vision of key indicators and reporting approaches. Major companies such as Microsoft and SAP are now active in this space. In this context, the open-sourced Extensible Business Reporting Language (XBRL) system of tagging data has been identified as a potentially convenient platform for collecting and analysing financial and non-financial data.

### **No mutual exclusivity**

Finally, it is important to note that the SR frameworks and approaches mentioned above are not necessarily mutually exclusive. Companies can (and do) use the GRI framework, for example, for broad-based reporting on economic, social and environmental performance, add to this by using more detailed information required by an international standard (e.g. on greenhouse gas emissions), and complement it further with sector-specific performance data, sometimes using a GRI Sector Supplement or other approach.

## THE CURRENT STATE OF SUSTAINABILITY REPORTING – ACHIEVEMENTS

As the 2012 UN Conference on Sustainable Development approaches, it is timely to take stock of the achievements of the first generation of sustainability reporting – in what is described here as ‘SR 1.0’ – over the last two decades. What and how has it contributed to sustainable development in practical terms?

The most obvious and important contribution can be seen at a fundamental behavioural level. Whereas SR was only a half-articulated idea in 1992, it is now a fully formed – though still evolving – concept. In terms of process, SR frameworks have emerged and are being used; sustainability reports now complement financial accounts; service providers (including the ‘Big Four’ accounting firms) offer a mix of advisory, communications and assurance services; ratings agencies use SR to help analyse company value and management; academic articles are written; and performance awards are given. In terms of content, unprecedented volumes of information on sustainability issues are now collected, analysed, shared, and evaluated by reporters and their stakeholders. The data are being used by an increasing number of organizations – mainly in the private sector – to determine their business strategy and relationship with suppliers and other stakeholders.

As already noted, stakeholders from around the world have played a critical role in proposing, shaping, launching, using and providing feedback on SR frameworks. To get a clearer sense of what stakeholders currently assess to be the strengths and weaknesses of SR, Chatham House conducted a global survey during September/October 2011. Respondents, representing most major stakeholder groups, identified the following issues as the ‘greatest benefits’ of SR to date.<sup>2</sup>

- *Data transparency:* The fact that SR had generated more transparency than ever before on organizational sustainability policies and practices was seen as the most important contribution of SR.
- *Organizational governance:* On a closely related point, most respondents also highlighted the role SR had played in providing organizations and their stakeholders with more data on which to make strategic decisions.
- *Reporting universe:* Stakeholder respondents also underlined the role that SR had played in getting more organizations to think about sustainable development issues.
- *Stakeholder engagement:* Along with the Reporting universe (above), respondents gave equal recognition to the role that SR had played in encouraging reporting organizations to take into consideration the views of their stakeholders.
- *Data comparability:* Notable SR benefits mentioned by respondents also included the generation of more comparable data on organizational performance, so that peer organizations could be benchmarked.

Other stakeholder feedback drew attention, variously, to the contribution of SR to: more ‘connected thinking’ within organizations; greater efficiency and capacity to track progress towards sustainability goals; and increased employee engagement. As one respondent put it, organizations could better ‘measure what matters’. In the main, this feedback echoes academic analysis and practitioner literature, which also commonly profiles the contribution of SR to greater awareness of sustainability issues, and related reputation, risk and stakeholder management capacity.

While SR still has many problems to address, it is probably not going too far to describe its advent as revolutionary. In the absence of an international convention or widespread national legislation, or a high-level initiative by a global business association, an entirely new disclosure practice has emerged and been adopted by many of the world’s largest business organizations. By any measure, this is a historic achievement and one deserving of recognition. As data on GRI use indicate, the GRI framework has been at the centre of this development.

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<sup>2</sup> The Chatham House survey elicited 92 responses from around the world. Respondents included almost equal proportions from the private sector, NGO and advocacy sector and consulting sector; and almost equal numbers of users/non-users of GRI. The majority of them were active on SR issues at various levels (e.g. helping to develop SR frameworks, preparing and reading SRs).



## OUTSTANDING ISSUES

Nevertheless SR displays a number of perceived weaknesses that will need to be resolved if more rapid and widespread progress is to be made. Criticisms of SR in general, or of frameworks such as GRI in particular, frequently point to perceived problems with both the *quantity of reporting* (e.g. too few reporters, too much or too little data) and its *quality* (e.g. too little accurate, complete or comparable information on what really matters). The more detailed critique of these and related points, below, also draws on the recent Chatham House survey, as well as on diverse practitioner feedback and academic literature.<sup>3</sup>

### Incomplete reporter universe

A commonly heard concern is the fact that the majority of companies (and for that matter, all other organizations) do not practise SR in any routine or rigorous manner. The evidence suggests that not more than 4,000 of the estimated 80,000 multinational corporations in the world report on their sustainability policies, practices and impacts. An even smaller percentage of small and medium-sized enterprises (SMEs) undertake SR. The same is true of public agencies and civil society organizations. Even less information is available on the use and impacts of the non-triple bottom line SR frameworks and approaches described in the previous section.

### Data materiality

As with financial accounting, the principle of materiality is that only such data should be reported as shareholders and other stakeholders would reasonably regard as necessary to make informed decisions. Under this heading, concerns have been expressed that data reported in sustainability reports are often incomplete, not linked to issues regarded as material, or not well linked to the company's business strategy or financial performance. Financial analysts claim to miss the data needed to make accurate valuations. Civil society and community representatives, for their part, often complain of an absence of data showing reduced harmful impacts ('reporting is not the same as doing'). As with financial accounting, the absence of full and accurate sustainability data can create information asymmetries that hamper the efficient working of capital markets in pricing risk and valuing management performance.

### Data comparability

While one of the GRI's objectives is to make performance data comparable across like organizations, the voluntary nature of SR means that this is not always possible. If reporters use the same standard (e.g. on reporting greenhouse gas emissions), the chances of data being consistent and comparable increase. In practice, however, this is not always the case. Further improvements in data reporting consistency would probably require the development of more detailed international standards or regulation.

### Incentive structure

Some commentators point to a range of factors that inhibit wider SR uptake. These include the absence or inconsistency of governmental SR policy; the emphasis on quantitative rather than qualitative data; the high transaction cost for SME reporters considering SR; and the limited scope for reporters to highlight positive impacts of their actions. To this might be added some level of confusion about what framework to use. Concern is also expressed as to the need to avoid a 'tick box mentality', which reduces SR to a compliance-driven rather than a strategically driven process.

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<sup>3</sup> Examples include: Rory Sullivan, *Valuing Corporate Responsibility: How Do Investors Really Use Corporate Responsibility Information?*, Greenleaf, 2011; Christopher Marquis and Michael W. Toffel, 'The Globalization of Corporate Environmental Disclosure: Accountability or Greenwashing?', Harvard Business School Working Paper, 2011; Ioannis Ioannou and George Serafeim, 'The Consequences of Mandatory Corporate Sustainability Reporting', Harvard Business School Working Paper, 2011.

## Assurance

Questions around the accuracy and completeness of reported information are a recurring critique. Many SR reports are either not, or only partially, assured, notwithstanding the availability of a number of accepted assurance standards (such as the AccountAbility 1000AS standard). There is also disagreement about who should assure SR reports. Currently there is both a formal process (i.e. assurance using qualified assurers) and an informal one (i.e. stakeholder feedback). Suggestions have been made that until sustainability data are subject to the same level of detailed, independent and professional assurance as financial accounting, SR will not be as valued or credible.

A number of other critiques are made from time to time. These include:

- *Cost*: the financial cost of doing SR can represent an excessive burden, especially for SMEs.
- *Convenience*: linked to the materiality point above, the argument is made that none of the existing frameworks is user-friendly, especially for smaller organizations.
- *Readership*: the claim is also made that ‘no one reads’ sustainability reports, thereby undermining interest in the SR process as a whole.

While many of these issues undoubtedly represent genuinely held concerns on the part of many stakeholders, and need to be considered in the development of SR 2.0, a few qualifying remarks are appropriate.

*Cost*: Frameworks such as GRI have survived three review processes, in which business and other users were actively engaged. This, combined with the fact that business organizations in particular continue to use them, voluntarily, suggests that the reporters and other stakeholders judge that the SR process has value. This conclusion is also supported by reporter feedback, which often mentions better understanding of stakeholder views, increased employee engagement and the ability to identify emerging sustainability issues and markets among the other advantages referenced in the *Achievements* Section.

*Convenience*: There is no doubt that SR requires additional effort. However, it should be noted that frameworks like GRI allow first time reporters to start simply, by reporting on a small number of the issues of most concern to them and their stakeholders. Moreover, many larger companies (such as Wal-Mart) are now also requiring their suppliers to provide information on their social and environmental practices. This makes SR an increasingly expected practice for smaller companies wishing to do business in a global supply chain economy.

*Readership*: This issue also deserves closer consideration. Financial reports, too, have a limited readership. The important question may be not so much how many people are reading, but what the capacity of the readership is to understand, challenge and use the disclosures made. It only takes one person to read and ask the right question (e.g. at a shareholder meeting or in the media) for the process to be effective. Several service providers now offer readily accessible summaries of the key aspects of sustainability reports, thereby lowering the transaction cost of reading and analysing.

## IMPROVING SUSTAINABILITY REPORTING – STAKEHOLDER SUGGESTIONS

SR 1.0 has created a whole new practice and level of disclosure. In its present form, however, it seems clear it does not fully meet stakeholder needs and the need to ensure that more organizations contribute to sustainable development. A new phase of SR is required. In considering what SR 2.0 might look like, it is important to note that there is no single solution to what are clearly a number of interrelated weaknesses in SR 1.0. Any discussion of how to improve SR immediately invites questions about ‘what part of SR’ and ‘what framework’. In response to the Chatham House survey question ‘what could be improved in the current state of SR?’, suggestions addressed most of the issues mentioned above.

In particular, respondents prioritized the need for improvements to:

- the accuracy and comparability of SR data;
- the benefits and impacts of sustainability policies and practices;
- the universe of reporting companies;
- the reporting process to make it simpler and easier; and
- the assurance that SR data were more complete and material.

The survey results are also illuminating in relation to proposed solutions to these and other problems. Recalling that a theme of the survey was the role of stakeholders, the top three recommended actions were:

- *Providing feedback on reports:* Over 96% of respondents thought that it was either ‘quite important’ or ‘important’ that stakeholders needed to be more active in commenting on reports.
- *Improving reporting frameworks:* On the same basis, over 93% of respondents considered that more stakeholder involvement would be beneficial in efforts to improve reporting processes. Suggestions included improvements to make reporting more SME-friendly and to connect them with business strategy.
- *Mandating:* Nearly 85% of respondents thought that stakeholders needed to be more active in encouraging universal reporting through mandating actions.

On the last point, the comment was made that only through concerted action to mandate and require SR across all sectors could a truly level playing field be created to engage and drive innovation on sustainability performance. While little detail was offered on what form mandates might take, support was expressed for the ‘report or explain’ approach, where regulators made SR compulsory, but left to reporters the choice of reporting frameworks and key indicators – or the choice of explaining why they did not report.

## THE FUTURE OF SUSTAINABILITY REPORTING

In the context of sustainable development, sustainability reporting is arguably one of the best examples of how action taken by a partnership of stakeholders since the 1992 Earth Summit has helped to create and put into operation an entirely new sustainability practice. Together with other multi-stakeholder sector initiatives such as the Carbon Disclosure project, the Global Reporting Initiative has created a new level of awareness, information and engagement around the sustainability performance of organizations. Although promising, however, the practice is not yet widely or deeply enough observed to achieve sustainable development.

On the eve of the 2012 Rio+20 conference, the question that needs to be asked – and answered – is what future do governments, business and other stakeholders want for SR?

A number of important public policy issues are raised by the fact that the majority of large companies do no sustainability reporting. These include whether governments (as well as other stakeholders): have the necessary information to track progress being made towards sustainable development and to adjust policies accordingly; can properly price the risks that may be associated with non-reported information; understand how private-sector leaders are integrating sustainable development into business strategy and can encourage this process; are using different instruments to better harness the power of financial markets to support Green Economy and sustainable development objectives.

Put simply, can further measurable progress towards sustainable development be made unless there is greater transparency on what is being done, by whom, and with what impacts? If financial reporting is routinely required, what are the reasons why SR should not also be made a normal practice? If sustainability can only be achieved by all organizations reflecting on – and responding to – their unique sustainability contribution (including both positive and negative impacts), what other policy options can achieve this as effectively, or better than, SR?

As noted, the contours of SR 2.0 remain to be defined. Nothing is yet certain. At least five possible pathways lie ahead.

### Flag and fade

The first scenario is a sobering one. It is that, in spite of all the progress made, SR may have peaked and now become less popular. This might be driven by a number of factors: a prolonged global economic recession (with resultant narrow focus on near-term financial performance), mixed or unsupportive messages from government and other stakeholders about the real value of SR, or confusion created by the emergence of different reporting approaches (including ‘dashboard’, ‘impact’ and ‘integrated’ reporting), resulting in a ‘wait and see’ (or even ‘why bother?’) attitude.

### SR consolidation

The second scenario would see SR make steady but incremental progress among large publicly listed companies, and improvements in the depth and quality of reporting. The GRI G4 Guidelines (due for release in 2013) would address a number of the user suggestions for improvements. Reporting would continue to be based primarily on the GRI framework and cover economic, social and environmental performance and positive impacts, but the number of reporters would increase at a linear, rather than exponential, rate. The Integrated Reporting framework (also due for release in 2013) would then be tested by a number of (probably) existing SR reporters. If the GRI experience is anything to go by, this could raise as many questions as it answers. As a result, there would still be far from universal uptake of SR by all large private companies and public organizations by 2015 or even 2020.

### Issue-specific SR

The third scenario would be characterized by increased attention to issue- or sector-based reporting. This might be driven by growing regulator or market demands on specific companies or sectors that have a special impact on one or other sustainability issue (in relation to carbon trading

mechanisms, for example). The attractions of such an approach could include standardized reporting requirements, thereby enhancing data comparability and the link with financial performance (e.g. carbon trading). Disadvantages would include that important messages about economic, social performance or non-‘priority’ issues might be ignored or under-emphasized.

### **Combined financial and SR**

A fourth scenario might involve integrating sustainability reporting into the framework of financial reporting. This could entail the development of a new international reporting framework or standard, such as that proposed by the International Integrated Reporting Committee, which enables companies and other organizations to report both their financial and sustainability performance in a single report, with a focus on the most material environmental, social and governance issues. This could result in far higher levels of awareness of sustainability issues and of reporting, and be seen as the natural successor to SR. Accompanying risks could include diminished disclosure of broad-spectrum sustainability performance data, over-emphasis of market-value considerations, and reduced stakeholder engagement. Given the early phase of the concept’s development, however, it is difficult to speculate on how it might operate until a functioning framework is proposed.

### **SR the new normal**

The fifth scenario would see crystallization of the recognition that SR is as important as financial performance data to good organizational governance and decision-making. For this reason, and building on the frameworks and momentum already achieved, it would be agreed by governments that the time has come to make SR mandatory. This might be done at a national or international level. As proposed by some organizations in the context of Rio+20, one option might be to explicitly shift to non-reporters the burden of explaining why an organization does not disclose sustainability data. This so-called ‘report or explain’ approach could take the form of light regulation. For example, this might make SR mandatory, but offer organizations two choices: either to explain publicly why they don’t report on sustainability aspects, or to report, but with full freedom to select a framework of their choice.

As noted in the context of the different forms of SR in the *Frameworks* Section, the future SR landscape could also see the continued parallel development of a number of frameworks and approaches. Indeed, in the absence of a clear and concerted intervention by government, business or other stakeholders, it seems likely that the current diversity of approaches will continue for some time. While this may offer potential user advantages such as flexibility and choice, it carries with it the risk that SR will remain an activity practised mainly by large publicly listed multinational companies, and that the current lack of awareness, proliferation of approaches and resultant confusion will deter wider uptake and use.

## CONCLUSIONS

While the future overall direction of SR remains unclear, a few conclusions may be drawn.

**More demand for sustainability information is to be expected.** The ‘Sustainability Genie’ is out of the bottle. As a matter of good management, large organizations are now routinely measuring their water use, carbon emissions, stakeholder views and so forth. As sustainability challenges become more apparent and urgent, it is virtually unthinkable that there will be less demand for SR in the future, whether the demand comes from regulators, investors, business itself or civil society. Importantly, however, the type and quality of information provided and how it is used will be determined in large measure by where the demand is coming from (e.g. regulatory, market, civil society) and how loudly the demands are made.

**Universal reporting is the goal.** While SR by the majority of large listed companies is a good development, it cannot be left at that level, whatever improvements are made in the quantity and quality of their reporting. If progress is to be made towards intergovernmental commitments on sustainable development, and societies and businesses are to become more resilient to climate change and other challenges, from a public policy perspective the creativity and contribution of all organizations will need to be harnessed. On top of that, the current sustainability information asymmetries in the market place are undermining the efficient operation of capital markets. To ensure a level playing field, universal SR would seem to be essential. In this respect, SR will also be vital to the development of a Green Economy.

**Stakeholders will determine SR 2.0.** The various approaches to SR 1.0 were all developed by stakeholders. In the same way, it will be stakeholders who determine the eventual shape of SR 2.0. The stakeholder appetite for engaging in the issues and in particular the strategy for addressing the challenges and possible scenarios will shape what SR 2.0 looks like, and how it is used. Limited stakeholder interest could see SR growing less rapidly or losing content, while increased interest could drive demand for more and better disclosure and frameworks. The Annex table offers examples of the ways in which governments and other stakeholders could improve the effectiveness of SR frameworks and practices.

**GRI remains the default option.** Whether one uses GRI or not, or likes it or not, it will remain the dominant triple-bottom-line SR framework. It will continue to occupy this position until such time as another framework (e.g. the proposed Integrated Reporting framework) offering demonstrably superior benefits is developed. Even under such a scenario, GRI is likely to command an ongoing level of support until any new framework is in place and proven. The fact that GRI is itself continuing to evolve and is embedded in existing management and software-based systems will make it harder to displace. For current and potential SR reporters or users, the choice is whether to work on improving GRI, complementing it or replacing it.

**More government incentives are needed.** Universal SR by large companies and other organizations will not be achieved without intervention by government. The incentives for SR are currently not strong enough to change mainstream attitudes and behaviour among non-reporters. Governments will continue to have a decisive role, whether in the form of mandating SR, providing policy incentives (e.g. making SR a condition of tendering for government procurement contracts), encouraging stock exchanges and private regulators to require it, raising business awareness about its benefits, requiring public agencies to issue SRs, or supporting SR initiatives (see Annex).

**More software tools can help SR be more commonly used.** Popular consumer ‘Apps’ illustrate the potential of software to collect, process, share and add meaning to data. Software-based systems have the potential to revolutionize the availability, transparency and utility of sustainability data. While questions of competing approaches and providers will certainly be present, competition in the market-place is likely to result in lower costs and a greater choice of systems. As much as mandating, software developments (including for consumer application) could prove to be a decisive factor in making SR a normal practice, but will be dependent on clear and consistent signals from governments that SR is expected.

### Three sets of interrelated issues stand in the way of the more widely practised and used SR:

**Quality of information:** The main issue from a market perspective is that sustainability information is not always clearly linked to financial performance or a company's business case. While regulators and stakeholders should be sensitive to cost-effectiveness and transaction cost issues, the hard truth is that many sustainability issues will never make business sense until the underlying economics, which fail to price in the cost of pollution or human rights abuses, are addressed. In this context, more sustainability information is likely to become increasingly challenging as it exposes gaps between sustainability goals (e.g. cuts in CO<sub>2</sub> emissions) and actual performance. Stakeholder suggestions for improvements in the comparability, accuracy and materiality of information need to be seen in this light.

**Quantity of information:** For many, challenges under this heading include how to ensure that all organizations, including SMEs, report and that all material information is reported (but not so much and in a form that is unintelligible). While SMEs represent the largest number of private enterprises, are collectively the biggest employers and are significant users of energy and resources, they are also 'fast followers'. The strategy, adopted by many SR frameworks, of focusing first on larger enterprises has probably been the most efficient one. If SR 2.0 can improve the ease of data collection and analysis, and make the business strategy links clearer for large organizations, SMEs will quickly pick up on these benefits, including in the supply chain context.

**Absence of regulation:** Financial performance data is routinely reported, however inconvenient and costly, precisely because it is judged to be vital. It is mandated because of a general agreement that financial transparency is the cornerstone of good management and financial responsibility. Financial performance is material to all stakeholders – whether management, employees, regulators or customers. Rightly, the same arguments are now being made with respect to sustainability disclosures. In 2012, how can it be regarded as responsible or risk-free behaviour by any large organization not to measure and report greenhouse gas emissions, and have policies in place for their reduction?

If the experience of financial reporting is any guide, standardization and regulation are the only way of ensuring that all organizations disclose increasingly vital performance data. If governments (and markets) wish to ensure that all organizations take into account – and put a value on – sustainability performance, the time has come to reconsider the role of regulation. The UN Rio+20 conference offers a timely and unique opportunity to help ensure that SR 2.0 learns from the experience of SR 1.0 and delivers its full potential to contribute to sustainable development.

## ABOUT THE AUTHOR

Paul Hohnen is an Associate Fellow of Chatham House. A former Australian diplomat, he was closely involved in the development and launch of the Global Reporting Initiative (GRI). He has also been actively engaged with a number of the leading international corporate responsibility initiatives, including the UN Global Compact, the OECD Guidelines for Multinational Enterprises and the ISO 26000 Guidance standard on social responsibility.

## ANNEX: POSSIBLE ACTIONS BY STAKEHOLDERS TO IMPROVE SUSTAINABILITY REPORTING FRAMEWORKS AND PRACTICES

SR issue	Stakeholder group and response options
Expand universe of reporters	<p>Governments <i>(e.g. incentivize, encourage, mandate SR reporting; require ratings agencies and stock exchanges to use ESG data; support (e.g. politically, financially) initiatives to improve SR frameworks)</i></p> <p>Business <i>(e.g. use frameworks of choice; promote SR through business associations; require SR by suppliers and subsidiaries; develop software tools; continue to help co-develop/improve reporting frameworks; call on governments to provide incentives and support for reporting)</i></p> <p>Civil society <i>(e.g. use frameworks of choice; promote among peer organizations; make use of SR a condition of partnership with business organizations; continue to help co-develop/improve reporting frameworks; call on governments to provide incentives and support for reporting)</i></p>
Improve quality of data (including materiality and link to financial accounting)	<p>Government <i>(e.g. routinely monitor and use SR data streams as part of efforts to drive progress towards a Green Economy and sustainable development; provide feedback as necessary on inaccurate or missing data; participate in and/or support efforts to improve SR frameworks on materiality and related issues)</i></p> <p>Business <i>(As above)</i></p> <p>Civil society <i>(As above)</i></p>
Improve quantity of data (i.e. from existing universe of reporters)	<p>Government <i>(e.g. routinely monitor and use SR data streams as part of efforts to drive progress towards a Green Economy and sustainable development; provide feedback as necessary; participate in and/or support efforts to improve SR frameworks on materiality and related issues.)</i></p> <p>Business <i>(As above)</i></p> <p>Civil society <i>(As above)</i></p>