Global Reporting Initiative™

REPORT OR EXPLAIN:

A smart EU policy approach to non-financial information disclosure

Global Reporting Initiative (GRI) non-paper on the Renewed EU Strategy 2011–2014 for Corporate Social Responsibility (CSR) and the European Commission's proposal for a Directive on non-financial information disclosure

This document is for policy makers and stakeholders involved in the non-financial information reporting debate. It provides a rationale for a policy approach which, in GRI's view, will help meet the needs and responsibilities of governments, businesses and society without adding unnecessary burdens. The purpose is to prompt debate and action from all interested stakeholders, particularly around the new European Commission proposal for a Directive on non-financial information disclosure. According to the provisions put forward, large companies in the EU will have to disclose information on policies, risks and results for environmental, social and employee-related issues, and human rights, anti-corruption and bribery issues, as well as on diversity on boards of directors. The proposal introduces a 'report or explain' approach, and encourages companies to rely on existing internationally-recognized frameworks for reporting, including GRI's Guidelines.

Executive summary

- In the **Renewed EU Strategy 2011-14 for Corporate Social Responsibility**, the European Commission defines CSR as "**the responsibility of enterprises for their impacts on society**."[1] Through CSR, organizations can significantly contribute to the European Union's treaty objectives of sustainable development and a competitive social market economy. Helping mitigate the social effects of economic crises, including job losses, is part of the social responsibility of enterprises.[2] In order to assess these effects and impacts, it is crucial for organizations to monitor, measure and report.

- Joining a growing number of countries that pioneered sustainability disclosure, such as Denmark, France, India, China, the UK and the US, the European Commission has adopted a **proposal for a Directive to amend the current legislative framework on non-financial information** disclosure in the EU. The Global Reporting Initiative (GRI)[3] welcomes this proposal and believes that this is an opportunity for the EU to continue to lead on setting out the road to a sustainable and knowledge-based global economy.

- Sustainability reporting is a vital step to achieving **smart**, **sustainable** and **inclusive growth**[4] that combines long-term profitability with social justice and environmental care. It can be used to inform the strategy necessary for risk analysis so that businesses can thrive - transparent companies tend to be more successful.[5]

- A **culture of corporate transparency** would contribute to a more **accountable and responsible business environment**. This transparency builds trust and increases brand value, boosts business performance and helps long-term sustainability. Non-financial information is also essential for the adequate functioning of the market.

- International organizations such as the United Nations Global Compact (UNGC), the Organisation for Economic Co-operation and Development (OECD), and the International Organization for Standardization (ISO), provide normative frameworks that help organizations shape their vision and management approach regarding sustainability. Companies, inspired by these principles, can use the **GRI Sustainability Reporting Framework** to report their sustainability impacts and performance. GRI's Framework has a comprehensive scope, is compatible with the main international frameworks, and covers material topics such as the **environment**; **labor**; **human rights**; **anti-corruption and bribery**; and **governance**.

- Sustainability reporting has been growing in the last decade; 95% of the world's 250 largest companies are already producing sustainability reports. However, overall less than 10% of publicly traded companies, and companies that do business across national borders, report on their sustainability practices.[6]

- Policies on sustainability reporting are already in place in several EU countries, as well as in China, India and the US. However, **the legislative framework is still fragmented and heterogeneous**. The proposal of the European Commission on non-financial information disclosure is an important and effective step to address this issue.

- A basic common principle is necessary for harmonization of sustainability reporting in the EU. It can be found in the **report or explain approach** that requires companies to either report on their sustainability impacts or explain why if they do not. This smart approach creates a flexible and equitable environment, which benefits businesses and drives innovation. It leaves the choice to report to companies, while promoting a culture of transparency. It targets large companies, and could also encourage SMEs[7], which represent a main share of European businesses,[8] to assess and report on their social and environmental impacts.

Sustainability reporting – benefits for business, markets and society

Through responsible and sustainable business conduct, companies can have a positive impact on society and contribute to smart, sustainable and inclusive growth in the EU. Reporting enhances companies' accountability for their impacts and contributions and therefore enhances trust, facilitating the sharing of values on which to build a more cohesive society.

The value and benefits of disclosing sustainability information (referred to as non-financial information disclosure by the European Commission, used synonymously in this document) are well-recognized and documented.[9] Governments, businesses and stakeholders directly benefit from it, and the positive impact on social, environmental and human rights issues is evident.

Benefits of sustainability reporting	
For companies	For markets and society
▪ Helps communicate risk management information to investors ▪ Increases awareness of risks and opportunities ▪ Emphasizes link between financial and non-financial performance ▪ Benchmarks and assesses sustainability performance with respect to laws, norms, codes, performance standards, and voluntary initiatives ▪ Streamlines processes, reduces costs and improves efficiency ▪ Influences long term management strategy and business plans ▪ Compares performance internally and externally ▪ Helps to manage and communicate Environmental, Social and Governance performance ▪ Enables businesses to directly contribute to building a Green Economy ▪ Improves reputation and brand loyalty	▪ Addresses buyers and investors' concerns about the social and environmental quality of business ▪ Strengthens competitiveness ▪ Encourages investment ▪ Enables job creation (direct and indirect impact) ▪ Critical source of information for affected communities and stakeholders ▪ Mitigates and improves companies' impact on society, local economy and environment ▪ Enables external stakeholders to engage with and understand companies' true value, and tangible and intangible assets

Table 1. Overview of internal and external benefits of sustainability reporting.[10]

Sustainability reporting can also increase innovation and competition[11]; it drives continuous performance improvement and increases accountability. Sustainability reporting can enable job creation both directly, in terms of staff hired by companies to support and manage the reporting system, and indirectly, by creating a more sustainable and stable economy.[12] Furthermore, it encourages good management and serves as an incentive for the establishment of a culture of corporate transparency which contributes to creating accountable and responsible business. Sustainability reporting is crucial in order to achieve smart, sustainable and inclusive growth which combines long-term productivity with social and environmental integrity.

Sustainability reporting – positive impact on markets and society

Recent years have seen an increasing interest from markets in the sustainability performance data disclosed in reports.[13] Information brokers such as Bloomberg now offer environmental, social and governance (ESG) performance data on thousands of companies on more than 350,000 terminals worldwide. Sustainability reporting is increasing and mainstream financial analysts have already started to include sustainability information in their analyses.[14]

Markets, however, will not treat sustainability information seriously as long as only a minority of companies report. A critical mass of sustainability information is needed to inform markets and enable performance benchmarking and analysis. In this respect, it can be argued that companies that do not report sustainability data withhold vital information from markets, which is needed for the assessment of medium to long-term risk and value. These gaps and asymmetries of information could lead to additional costs for markets and undermine their effective functioning.

Through responsible and sustainable business conduct, companies can have a positive impact on society. The transparency that comes with reporting enhances companies' accountability for their impacts and contributions and therefore builds trust, facilitating the sharing of values on which to build a more cohesive society.

For these reasons, several governments, including some European member states, have already developed and introduced national policy initiatives to promote sustainability reporting.[15]

Sustainability reporting – a growing worldwide trend but more must be done

Governments, international organizations, stock exchanges and a number of private initiatives have developed policy, regulation, requirements, and guidelines to promote sustainability reporting.[16] Countries such as China, Denmark, France, India and the US have introduced policies on sustainability reporting.[17]

Sustainability reporting has increased worldwide in the last decade.[18] More and more, the practice is seen as an important gauge of the quality of an organization's governance processes and long-term business strategy. Businesses generally seek to make a profit by pricing competitively and driving down costs. Costs should not just be set against financial accounts, but also against economic, social and environmental ones. The market for more sustainable products and services is also expanding. A growing number of organizations have recognized these factors and begun to act on them.

Thousands of organizations worldwide now produce sustainability reports. In 2011, 95% of the largest 250 companies worldwide issued sustainability reports, up from around 80% in 2008 and 50% in 2005.[19] European companies have traditionally been ahead on this issue, leading with a remarkable 71% of the largest companies reporting.[20] While the number of reporters is growing and the quality of reporting improving, sustainability reporting has yet to achieve its full potential: The adoption of the practice is too slow. For example, it took 12 years for the proportion of the world's largest 250 companies practicing sustainability reporting to grow from 35% to 95%. At the current rate it would take decades before sustainability reporting would become common practice across global markets. An estimated 4,500 organizations are included in sustainability reporting databases – a small fraction of the more than 45,000 publicly traded companies that are required to disclose their annual accounts and the estimated 82,000 corporations that do business across national borders globally. This means that regulators, investors and stakeholders know little or nothing of the sustainability practices and impacts of the vast majority of the world's large companies.

Sustainability reporting – State of Play in the EU

The European Commission defines Corporate Social Responsibility as "the responsibility of enterprises for their impacts on society."[21] Monitoring, measuring and reporting are crucial in order to assess such impacts. Transparency to a wide stakeholder group creates an impetus for improving performance and sustainability reporting practices, enabling companies to measure, monitor and manage their impact on society and the economy, and help contribute to a sustainable future.

More and more companies in the EU report on their sustainability and the quality of reporting is constantly improving. The Modernization Directive[22], with its provision to include (where appropriate, and to the extent necessary for an understanding of the company's development, performance or position) sustainability information in the annual report, has in recent years helped raise awareness among companies about the importance of sustainability information disclosure. Member states have implemented this Directive and some have further developed national regulation and policy initiatives on sustainability reporting, contributing substantially to the uptake of the practice among companies.[23] However, this soft approach to reporting has reached its limit as the practice is not yet mainstreamed and many companies still do not disclose sustainability information.[24] s

In 2011 the European Commission launched a Renewed EU strategy 2011–2014 for Corporate Social Responsibility[25] in pursuit of the Europe 2020 objective for smart, sustainable and inclusive growth.[26] This ambitious plan resulted in various initiatives for its implementation. In February 2013 the European Parliament adopted two resolutions on CSR, which include suggestions and policy recommendations, and call for the European Commission to take concrete steps on sustainability reporting and transparency.

The European Commission, recognizing the shortcomings of the current legislative framework on sustainability reporting,[27] in April 2013 adopted a proposal for a Directive to improve the transparency of certain large companies on social and environmental matters.[28] According to the provisions put forward, all large companies in the EU will have to disclose information on (a) policies, (b) risks and (c) results as regards environmental, social and employee-related issues, and human rights, anti-corruption and bribery issues, as well as information on diversity on boards of directors.[29] GRI welcomes this initiative and believes that this is the opportunity for the EU to offer clear direction to businesses, create a consistent approach to reporting, and to lead the way to a sustainable and knowledge-based global economy.

GRI recommendations for a smart(er) policy approach: Report or Explain

A smart policy would harmonize the fragmented policy landscape in the member states, promoting sustainability reporting while leaving due flexibility. An EU approach would create a level playing field in the internal market. The European Commission's proposal on non-financial reporting – which introduces reporting requirements for larger companies, based on a report or explain approach – is a great step forward in this regard.

GRI welcomes this proposal and encourages the European Parliament, the Council of the European Union, and all interested stakeholders to build on this important step and work towards the development of a smart, yet flexible, European policy framework for sustainability reporting, which:

- **Creates a level playing field**: An EU approach would offer a harmonized policy environment where companies can operate effectively. The policy should regulate the floor and leave full flexibility to companies. Companies should disclose information that is material (i.e., that reflects the organization's significant economic, environmental, and social impacts, or that substantively influences the assessments and decisions of stakeholders[30]). If companies decide not to disclose information, they should be required to explain why they do not.

- **Promotes transparency to enhance trust:** Markets can only be effective when relevant information is available. Sustainability reporting information is essential to establish trust, paving the way for smart, sustainable and inclusive growth. Therefore, policy requirements would help ensure that the information needed by markets and society to assess a company's management and performance is provided. Investors and customers would then be able to make informed decisions regarding penalties, premiums or voting as a consequence of disclosures - or lack of disclosure. Decisions would be based either on reported information, or the explanation for not reporting. Further, through the reporting process companies have the opportunity to engage stakeholders in dialogue.

- **Identifies important topic areas**, but **allows space for businesses to identify material information** to disclose. Companies should disclose information on at least the following material issues:
  - *Environment* (including climate change and biodiversity)
  - *Labor* (including gender issues and health and safety)
  - *Human Rights* (including child labor and non-discrimination)
  - *Anti-corruption* and *bribery*
  - *Governance* (including diversity on boards of directors)

- **Encourages the use of widely-accepted international frameworks to facilitate comparability.** GRI's Sustainability Reporting Framework offers companies indicators and guidance for sustainability reporting, and makes due links with the main internationally-recognized normative frameworks.[31] To shape their sustainability strategy and management, companies can rely on internationally-accepted normative frameworks such as:
  - *United Nations Global Compact (UNGC) Principles*[32]
  - *UN Guiding Principles on Business and Human Rights*[33]
  - *Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises*[34]
  - *International Organization for Standardization (ISO) International Standard for social responsibility (ISO 26000)*[35]
  - *International Labour Organization (ILO) Tripartite Declaration of principles concerning multinational enterprises and social policy*[36]

- **Stimulates innovation.** By monitoring and reporting their sustainability performance, companies would be better placed to consider innovative ways to improve their performance and increase their contribution to sustainable growth. Evidence from the last decade suggests that sustainability reporting encourages businesses to include sustainability in their business strategy and bring to market new products and services, therefore representing a powerful source of innovation.

- **Enhances good governance.** Corporate governance can be considered responsible if it takes sustainability issues into account. By linking non-financial disclosure to boards' approval of annual reports, the policy maker promotes a culture of transparency and sustainability within the company, incentivizing good governance.

- **Allows flexibility and limits administrative burdens.** A policy based on a report or explain approach would be relatively simple to enact and implement. It does not require complex or prescriptive regulation, nor is it overly burdensome for companies and policy makers to implement. It could be required by governments and also by market actors and regulators, such as stock exchanges. The resulting democratization of sustainability information would see markets and society as a whole play a monitoring, assuring, promoting, and enforcing role.

- **Addresses the requirements to large companies** only, as those with significant sustainability impacts in the EU market. Small and Medium Enterprises (SMEs) should be exempted from the requirements but nevertheless encouraged to issue sustainability information. Reporting helps SMEs to improve internal processes and set goals, and to enhance reputation and trust, contributing to competitive advantage. Reporting therefore enhances their position in the market, for example allowing access to the supply chains of large companies.

- **Links with the Europe 2020 strategy.** A common report or explain approach in the EU would ultimately make more and better quality sustainability information available. This would enable better monitoring of progress, support, and the refining of policies towards the Europe 2020 Strategy.

Models based on these principles have already been successfully adopted by several governments, including the Danish and French Governments, and have proven to be an effective and practical way to trigger transparency without imposing it. In the case of Denmark, in 2011 98% of companies were motivated to report on any CSR strategies already in place and only 2% of companies reported for the first time. In addition, very few companies - only 3% - chose not to disclose any information at all.[37]

This is the right time for policy makers and stakeholders to act on ensuring the right approach for sustainability reporting in Europe that combines the interests of society, businesses, and markets. The European Commission's proposal for a Directive is a promising step towards consolidating a culture of corporate transparency in the spirit of smart, sustainable and inclusive growth.

[1] European Commission, *A Renewed EU Strategy 2011-14 for Corporate Social Responsibility [COM(2011) 681],* 2011. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0681:FIN:EN:PDF

[2] European Commission, *A Renewed EU Strategy 2011-14 for Corporate Social Responsibility [COM(2011) 681],* 2011. Additionally, a number of the Europe 2020 flagship initiatives identify CSR and sustainability's role in job creation: the Integrated Industrial Policy for the Globalization Era COM(2010)614, the European Platform against Poverty and Social Exclusion COM(2010)758, the Agenda for New Skills and Jobs COM(2010)682, Youth on the Move COM(2010)477 and the Single Market Act COM(2011)206.

[3] 'Global Reporting Initiative', hereafter referred to as 'GRI'.

[4] European Commission, *EUROPE 2020: A strategy for smart, sustainable and inclusive growth*, 2010. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:2020:FIN:EN:PDF

[5] European Commission, *Proposal for a Directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of non-financial and diversity information by certain large companies and groups. [COM(2013) 207],* 2013 http://ec.europa.eu/internal_market/accounting/docs/non-financial-reporting/com_2013_207_en.pdf.

[6] KPMG, *International Survey of Corporate Responsibility Reporting,* 2011. www.kpmg.com/PT/pt/IssuesAndInsights/Documents/corporate-responsibility2011.pdf

[7] As defined in the Seventh and Fourth Council Directives: European Commission, *Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts,* 1983 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31983L0349:EN:NOT ; and European Commission, *Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies,* 1978http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31978L0660:EN:NOT.

[8] European Commission, Directorate General Enterprise and Industry, Small and medium-sized enterprises (SMEs) http://ec.europa.eu/enterprise/policies/sme/index_en.htm., accessed on 3 April 2013.

[9] European Commission, *Competitiveness report, Chapter 5, 'Overview of the links between Corporate Social Responsibility and Competitiveness'*, 2008. http://ec.europa.eu/enterprise/policies/sustainable-business/files/csr/documents/csrreportv002_en.pdf ; and KPMG, *International Survey of Corporate Responsibility Reporting 2011*, 2011.

[10] Global Reporting Initiative, About Sustainability Reporting, www.globalreporting.org/information/sustainability-reporting/Pages/default.aspx, accessed on 3 April 2013.

[11] KPMG, *International Survey of Corporate Responsibility Reporting 2011,* 2011.

[12] European Commission, *Proposal for a Directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of non-financial and diversity information by certain large companies and groups. [COM(2013) 207]* , 2013

[13] KPMG, *International Survey of Corporate Responsibility* Reporting 2011.

[14] Bloomberg, *The Sustainability Edge – Sustainability Update*, 2011. www.bloomberg.com/bsustainfiles12/images/report_2011/2011_BloombergSustainabilityUpdate.pdf

[15] For more details on policy initiatives in Europe, consult GRI's website: www.globalreporting.org/initiatives-worldwide.

[16] For country specific information consult GRI's website: www.globalreporting.org/network/report-or-explain/initiatives-worldwide/Pages/default.aspx; or download Carrots and Sticks: www.globalreporting.org/resourcelibrary/Carrots-And-Sticks-Promoting-Transparency-And-Sustainbability.pdf.

[17] For more details on policy initiatives consult GRI's website: www.globalreporting.org/initiatives-worldwide.

[18] KPMG, *International Survey of Corporate Responsibility Reporting,* 2011.

[19] Ibid.

[20] Ibid.

[21] European Commission, *A Renewed EU Strategy 2011-14 for Corporate Social Responsibility [COM(2011) 681],* 2011.

[22] European Commission, *Modernization Directive, Directive 2003/51/EC of the European Parliament and of the Council of 18.6.2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings*, 2003. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32003L0051:EN:NOT.

[23] For more details of policy initiatives in Europe consult GRI's website: www.globalreporting.org/initiatives-worldwide.

[24] European Commission, *A Renewed EU Strategy 2011-14 for Corporate Social Responsibility [COM(2011) 681],* 2011.

[25] Ibid.

[26] European Commission, *EUROPE 2020: A strategy for smart, sustainable and inclusive growth*, 2010.
[27] The 'Accounting Directives' on the preparation of annual and consolidated financial statements. Specifically the 4th Council Directive of 25 July 1978 [78/660/EC] and the 7th Council Directive of 13 June 1983 [83/349/EEC].
[28] European Commission, *Proposal for a Directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of non-financial and diversity information by certain large companies and groups. [COM(2013) 207],* 1983.
[29] European Commission, *Proposal for a Directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of non-financial and diversity information by certain large companies and groups. [COM(2013) 207]*, 2013
[30] GRI, Second G4 Public Comment Period. Overview: www.globalreporting.org/resourcelibrary/G4-Exposure-Draft.pdf
[31] To see how these frameworks work complementarily to the GRI reporting system see: The Global Reporting Initiative (GRI) and the United Nations Global Compact (UNGC), *Making the Connection: The GRI Guidelines and the UNGC Communication on Progress,* 2007 www.globalreporting.org/resourcelibrary/GRI-UNGC-Making-The-Connection.pdf; The Global Reporting Initiative (GRI) and ISO 26000, *How to use the GRI Guidelines in conjunction with ISO 26000*, 2011 www.globalreporting.org/resourcelibrary/How-To-Use-the-GRI-Guidelines-In-Conjunction-With-ISO26000.pdf.
[32] UNGC 10 Principles : www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/index.html
[33] United Nations, *Guiding Principles on Business and Human Rights, Implementing the United Nations "Protect, Respect and Remedy" Framework*, 2011. www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf.
[34] Organisation for Economic Cooperation Development (OECD), *Guidelines for Multinational Enterprises*, 2011 www.oecd.org/daf/inv/mne/oecdguidelinesformultinationalenterprises.htm.
[35] International Organization for Standardization (ISO), International Standard for social responsibility (ISO 26000), www.iso.org/iso/home/standards/iso26000.htm, accessed on 3 April 2013.
[36] International Labour Organization (ILO), *Tripartite Declaration of principles concerning multinational enterprises and social policy,* 2006. www.ilo.org/empent/Publications/WCMS_094386/lang--en/index.htm.
[37] Danish Business Authority, *The Danish Financial Statements Act: Experiences after three years of mandatory reporting, 2011.* www.samfundsansvar.dk/graphics/publikationer/CSR/CSR_and_Reporting_in_Denmark_2nd_year_2011.pdf

The Global Reporting Initiative (GRI) promotes the use of sustainability reporting as a way for organizations to become more sustainable and contribute to a sustainable global economy.

GRI's mission is to make sustainability reporting standard practice. To enable all companies and organizations to report their economic, environmental, social and governance performance, GRI produces free Sustainability Reporting Guidelines.

GRI is an international not-for-profit organization, with a network-based structure. Its activity involves thousands of professionals and organizations from many sectors, constituencies and regions.

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