CARROTS AND STICKS – PROMOTING TRANSPARENCY AND SUSTAINABILITY

An update on trends in Voluntary and Mandatory Approaches to Sustainability Reporting

KPMG

UNIT FOR CORPORATE GOVERNANCE IN AFRICA

Global Reporting Initiative™

UNEP
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Project Partners

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UNEP represents the United Nations' environmental conscience. Based in Nairobi, Kenya, its mission is to provide leadership and encourage partnership in caring for the environment by inspiring, informing, and enabling nations and peoples to improve their quality of life without compromising that of future generations. UNEP's Division of Technology, Industry and Economics (DTIE) aims to help decision-makers in the public and private sectors to develop and implement policies and practices focusing on sustainable development. It works to promote sustainable consumption and production, the efficient use of energy and other resources, adequate management of chemicals, and the integration of environmental costs in development policies. Leading outreach activities with business and industry, sustainability reporting has for many years been a core subject of its work on corporate social responsibility.

United Nations
Environment Programme
PO Box 30552
Nairobi 00100
Kenya
Tel: +254 20 762 1234
Fax: +254 20 762 3927
www.unep.org

UNEP DTIE
15 rue de Milan
75441 Paris Cedex 09
France
Tel: +33 1 4437 1450
Fax: +33 1 4437 1474
unep.tie@unep.fr
www.unep.fr

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KPMG's Sustainability Services practices deliver assurance and advisory services in the field of corporate responsbility (CR), including reporting and assurance on CR reporting. For further information about our services please go to www.kpmg.com or contact:

Wim Bartels
Global Head of Sustainability Assurance at KPMG
Partner, KPMG Sustainability, the Netherlands
Tel: +31 20 656 7783
bartels.wim@kpmg.nl

The Global Reporting Initiative
The Global Reporting Initiative™ (GRI) is a multi-stakeholder non-profit organisation that develops and publishes guidelines for reporting on economic, environmental and social performance ('sustainability performance'). As the world's most widely-used sustainability reporting framework, the GRI Sustainability Reporting Guidelines are being used by organisations of all sizes and types, across sectors and regions. The Guidelines are developed through a unique multi-stakeholder consultative process involving representatives from reporting organisations and report information users from around the world. First published in 2000 and then revised in 2002, the guidelines have now entered their third generation, referred to as the GRI G3 Guidelines which were released in October 2006.

Global Reporting Initiative
PO Box 10039
1001 EA
Amsterdam
The Netherlands
Tel: +31 20 531 00 00
Fax: +31 20 531 00 31
info@globalreporting.org
www.globalreporting.org

Unit for Corporate Governance in Africa, University of Stellenbosch Business School
The Unit for Corporate Governance in Africa conducts multidisciplinary research, educational and development activities with the aim of improving the effectiveness of corporate governance in African organisations.
The Unit focuses on:
The development of the compliance and performance aspects of directors' attitudes, knowledge and skills
The link between corporate governance, business ethics and total organisational performance
The purpose of the Unit is to improve the effectiveness of corporate governance within African organisations, predominantly in the private sector.
The mission of the Unit is to develop both the compliance and the performance aspects of directors' attitudes, knowledge and skills, as well as the link between corporate governance, business ethics and total organisational performance.

Unit for Corporate Governance in Africa
PO Box 610, Bellville 7535, South Africa
Tel: +27 21 918 4342
Fax: +27 21 918 4468
governance@usb.ac.za
www.governance.usb.ac.za

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1. Executive Summary

This publication provides an up-to-date and expanded overview of mandatory and voluntary approaches to sustainability reporting and assurance.

In 2006 UNEP and KPMG issued a publication called "Carrots and Sticks for Starters, Current Trends and Approaches in Voluntary and Mandatory Standards for Sustainability Reporting", (UNEP and KPMG 2006) which gave a first time overview of sustainability reporting mandatory and voluntary approaches in a selection of countries worldwide.

This publication provides an up-to-date and expanded overview of mandatory and voluntary approaches to sustainability reporting and assurance. The updated publication covers most OECD countries, as well as new emerging market countries in addition to Brazil, India and South Africa, which were covered in the 2006 edition. It aims to provide readers with an easy reference and overview of basic legislative and voluntary requirements, in a format that allows comparison of approaches across regions and countries. The objective of the updated publication is also to revisit the debate about the advantages and disadvantages of both voluntary and mandatory approaches to sustainability reporting. For this publication we have also invited acknowledged experts in the field of sustainability reporting to provide input on selected topics.

This publication is the outcome of a collective effort of UNEP, KPMG Sustainability, the Global Reporting Initiative and the University of Stellenbosch Business School, with the support of many other experts and organisations (see Acknowledgments, page 91). The research partners believe that a variety of readers will find this publication useful. Regulatory bodies and government officials based in ministries responsible for relevant national laws including company law, corporate governance requirements and requirements for disclosure of financial and non-financial (social, economic and environmental) information will find guidance on current debates and can view examples of how different regulators have responded, as will reporting managers from multinational corporations, non-governmental reporters, company watchers and users of reporting information including analysts, consultants, and those who would benefit from easy, reliable and updated information on requirements in existing and new markets in which their organisations operate.

Over the last four years the regulatory landscape has evolved substantially in all parts of the world. More codes and regulatory measures are now available in more countries. A review of mandatory and voluntary sustainability reporting standards and legislation in 30 countries has revealed that both international and national standards, codes and guidelines as well as legislation for sustainability reporting have been strongly evolving. The increasing number of reporters seems to go hand in hand with an increasingly dense regulatory network of international and national standards, codes and guidelines as well as legislation for sustainability reporting.

Following an analysis of current trends and approaches in mandatory and voluntary sustainability reporting, an inventory of selected legislation, standards, codes and guidelines is provided.

Our research of existing approaches in the selected 30 countries[1] revealed the following:

- A total of 142 country standards and/or laws with some form of sustainability-related reporting requirement or guidance;
- Approximately two thirds (65%) of these standards can be classified as mandatory and one third (35%) as voluntary;
- A total of 16 standards with some form of reporting requirement at the global and regional level; and
- A total of 14 assurance standards.

In addition, there is a steep increase in companies, and some public agencies, issuing sustainability reports based on the GRI G3 guidelines. Research by KPMG in 2008 indicated that 79% of global 250 companies disclose ESG data and 77% of those use GRI to do so. A new phenomenon is that ten governments have a formal reference to GRI in their governmental corporate responsibility guidance documents and/or policies.[2]

There are many choices available to regulators, which are influenced by, amongst other things, geopolitical factors. However, there are a few general trends to be discerned. The first is a stronger role for the state

1 Australia, Austria, Belgium, Brazil, Canada, Chile, China, Denmark, Ecuador, Finland, France, Germany, Greece, Hungary, India, Indonesia, Italy, Japan, Luxembourg, Mexico, The Netherlands, Norway, Portugal, South Africa, South Korea, Spain, Sweden, Switzerland, United Kingdom, United States.

2 Austria, Belgium, Canada, Denmark, Finland, Germany, Netherlands, Norway, Sweden, United States.

in its regulatory role, to ensure a minimum level of disclosure and risk prevention. The second is an emerging emphasis on a combination of (complementary) voluntary and mandatory approaches and the third emerging trend is one of integration, resulting in a combination of corporate governance, financial and sustainability reporting into one reporting framework. This third trend may be a reaction in order to avoid new financial scandals and crises. It is also a sign of the maturing field of sustainability reporting, and can contribute to achieving the transition to sustainable markets and economies.

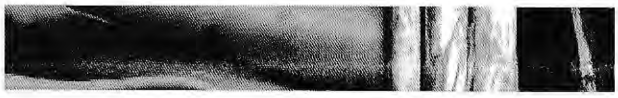
Based on the trends identified and the need to take the debate forward, we offer the following recommendations:

- A more active role for government regulators in sustainability reporting should be encouraged;
- Regulators should acknowledge the principle of complementarity – i.e. the regulator should raise the bar in terms of minimum reporting requirements, but leave enough space for voluntary disclosure and innovation;
- To encourage voluntary disclosure, beyond the minimum mandatory requirement, as well as innovation, regulators should consider relevant incentives;
- Mandatory standards should be simplified – this should be performed by stocktaking of standards at the country level and alignment with global standards where possible;
- All stakeholders should acknowledge convergence – stock exchanges, rating agencies and NGOs have to interact with regulators and reporters in order to take the debate forward;
- The option of integrated reporting should be seriously considered by all stakeholders, including regulators.

"This new report provides a thorough – and much-needed – look at a fast-changing and important element of reporting: the link to public policy on reporting. With new steps towards reporting requirements from the US Securities and Exchange Commission, in addition to steps taken in China, Sweden, South Africa and elsewhere, this publication will be very valuable for both new and experienced reporters."

Aron Cramer, President and CEO, Business for Social Responsibility

2. Introduction



Today the world is facing a rapidly changing economic, environmental and social situation resulting from both a financial and sustainability crisis.

The current global financial and economic crisis has sparked renewed interest in regulation, including corporate governance and disclosure requirements. In addition, the last three years have seen the introduction of significant changes in terms of reporting guidelines in many countries. For example, new requirements related to corporate responsibility have been introduced in Scandinavian countries, including a mandatory requirement for sustainability reporting by state-owned companies in Sweden. At the same time, there has been an increased focus on integration in reporting and further professionalisation of sustainability reporting. These developments signaled the need for doing a revised, updated version of Carrots and Sticks for Starters, which was published in 2006.

Sustainability reporting[3] enables organisations of all shapes and sizes, including companies and public agencies, to measure, manage and publicly disclose their economic, environmental and social performance.

Looking back...

Reporting debates in the United States (USA) and in Europe in the 1960s and 1970s were ignited by a new awareness of external responsibilities unfulfilled by governmental institutions and ones that business needed to account for. Early experiments with social reporting – Sozialbilanz or bilan social (a legal requirement in France since 1977 and practiced in the Netherlands since the 1960s) – paved the way for the introduction of the environmental report or Ökobilanz in countries such as Germany, Austria, Denmark and Switzerland. During the 1980s ethical investment funds in the UK and USA started screening companies based on their social and ethical performance. Following the 1989 Exxon Valdez disaster, the US-based Coalition for Environmentally Responsible Economies (CERES) developed The CERES/Valdez Principles on behalf of the Social Investment Forum. These principles introduced a tough set of environmental reporting guidelines. In the early 1990s UNEP and SustainAbility undertook global benchmarking of environmental and broader reporting. The 1990s saw increased reporting with more comprehensive coverage. This was epitomised for example by the Body Shop International's first Values Report (1995) in which it reported on environmental, animal protection and social issues. In 1997 CERES and UNEP launched the Global Reporting Initiative (GRI) process to develop guidelines for reporting on the triple bottom line: economic, environmental and social performance. The aim was to elevate sustainability reporting to the same level and rigor as annual financial reporting. As a multi stakeholder network organisation, GRI provided a forum where those who take an interest in environmental, social and governance (ESG) issues and those organisations or individuals working in the sustainability reporting field can come together to advance the sustainability agenda. The foundations of the reporting framework – the GRI Guidelines – are being continually developed by the network through a multi-stakeholder consensus seeking process to which anyone can contribute. The third version of the Guidelines – known as the G3 Guidelines – was published in 2006 and is a free public good. Since 2006 the world community has been using the third generation of the guidelines, the G3 Guidelines, and GRI has focal points in China, Brazil, India, and Australia.

Surveys in the Anglo-Saxon world of reporting trends in the 1990s showed that up to that time most companies focused on the disclosure of human resource issues. Human resource reporting was much more predominant than environmental reporting, since much disclosure in this terrain was mandatory rather than voluntary (Hibbitt, 2004: 79). Environmental reporting increased due to more governments focusing on heavy polluting industries and introducing compulsory registration of materials (a form of green accounting) and inventory of toxic releases. Also, the development of new environmental management standards such as the European Eco-Management and Audit Scheme (EMAS) encouraged site level reporting.

Developments in reporting ranged from legalistic and technical requirements under company law and accounting rules to managerial innovations and new demands by stakeholders, all of which resulted in the birth of the concept

3 See note on terminology later in this section.

of the comprehensive "corporate sustainability report" in the 1990s. It was a decade that was described by the London-based think tank SustainAbility as the "Transparency Decade", when a series of major incidents forced early pioneers to "come clean" and issue economic-social-environmental reports (SustainAbility and UNEP, 2002: 6). SustainAbility has suggested that the first decade of the 21st century might become the "Trust Decade". This decade was to be based on ever increasing transparency, accountability and reporting. However, the past few years have turned out to be years of "distrust". As a result of the global financial crisis and several corporate scandals, there is a general climate of distrust regarding companies' ability to self-regulate (Edelman Trust Barometer, 2009). Consequently, the general public is demanding an increased role to be played by governments in the sustainability reporting field.

Today the world is facing a rapidly changing economic, environmental and social situation resulting from a double crisis. Firstly, the global financial crisis and deepening economic recession are profoundly and negatively affecting our economies. This crisis is acute and visible. However, the world also faces a growing sustainability crisis: this complex web of interlinked economic, environmental and social developments poses a long-term threat to global stability and prosperity. This second crisis is evolving more slowly, but will ultimately have a wider as well as deeper, and, potentially, far more costly, impact. The sustainability and transparency agenda offers possible solutions to both crises.

The crisis has sparked renewed interest in regulation, including corporate governance and disclosure requirements. Increasingly, public opinion links the financial crisis with sustainability related crises, such as climate change. Investors and analysts are starting to assess investor value through ESG information. The general public, NGOs and investors are demanding an increased role for governments in the sustainability reporting field (Edelman Trust Barometer, 2009). In March 2009 the GRI Board issued its Amsterdam Declaration,[4] calling "on governments to take leadership by introducing policy requiring companies to report on ESG factors or publicly explain why they have not done so" thus following the "report or explain" principle inspired by the recent Danish law on reporting.[5] In 2009 the European Commission hosted a series of multi-stakeholder workshops on ESG disclosure culminating in a debate on a series of hypothetical scenarios, including some regulatory options, for the future of European policy on this issue.[6]

Various approaches can be followed to encourage sustainability reporting. On the one hand, the legislator can be passive and leave it to market forces, international or supranational bodies to drive organisations to report on sustainability issues, or they may support various non-governmental initiatives in their attempts to promote reporting. On the other hand, the legislator can choose to introduce one or more of the following measures:

- Mandatory regulations with an obligation to report;
- Incentives for companies to report;
- Governmental endorsement of the GRI G3 Guidelines and an encouragement to industry to use them;[7]
- Voluntary rules or guidelines relating to performance, with or without reference to international standards such as the UN Global Compact and GRI; or
- Transfer the regulatory power to self regulating authorities like the NYSE or a stakeholder panel whose statutes can be either voluntary or mandatory.

Over the past decade there has been a lively debate amongst proponents of voluntary and mandatory reporting standards. Vested interests and perceptions have often resulted in conflicting positions. Ten years ago corporations usually argued strongly in favour of voluntary standards whilst NGOs, pressure groups and trade unions demanded mandatory standards since they did not believe that corporations would disclose material information objectively unless they were required to do so by law. As explained in Carrots and Sticks for Starters, there have been many arguments for and against both mandatory and voluntary reporting (see Table 1).

4 Available at http://www.globalreporting.org/CurrentPriorities/AmsterdamDeclaration/ (last visited 9 February 2010)
5 Art. 99a Danish Financial Statements Act, available at http://www.csrgov.dk/graphics/Samfundsansvar.dk/Dokumenter/Proposal_Report_On_Social_Resp.pdf
6 Information available at http://ec.europa.eu/enterprise/policies/sustainable-business/corporate-social-responsibility/reporting-disclosure/swedishpresidency/index_en.htm

7 This is for example done by the Norwegian Government, as expressed in their CSR White Paper of January 2009.

	Reasons for	Reasons against
Mandatory approaches to reporting	• Changing the corporate culture – leaders will continue to innovate above minimum requirements • Incompleteness of voluntary reports • Comparability • Non-disclosure of negative performance • Legal certainty • Market failures – theory of regulation • Reduction of non-diversifiable market risk free rider problem • Cost savings • Standardisation • Equal treatment of investors	• Knowledge gap between regulators and industry • One size does not fit all • Inflexibility in the face of change and complexity • Lack of incentive for innovation • Constraints on efficiency and competitiveness
Voluntary approaches to reporting	• Flexibility • Proximity • Compliance • Collective interest of industry	• Conflicts of interest • Inadequate sanctions • Under-enforcement • Global competition • Insufficient resources

Table 1: Reasons for and against mandatory and voluntary approaches

During the last few years the debate has become more mature. There are now companies, investors and analysts that are promoting regulation, and trade unions that use voluntary standards amongst their members. Governments refer to the G3 Guidelines, which were developed as a voluntary reporting framework, in their implementation documents, guidelines and explanatory notes on legislative requirements.

The relationship between mandatory and voluntary approaches is framed differently today. Instead of presenting mandatory and voluntary sustainability reporting as exclusive options, they are in fact highly complementary. Assuming a complementary relationship between mandatory and voluntary approaches, the challenge for governments then becomes to determine the appropriate minimum level of mandatory requirements. For the reporting entities the question remains as to how much they would be prepared to do beyond their compliance with mandatory requirements. The reason for doing this is to gain a competitive advantage in both the present and the future (see Figure 1).

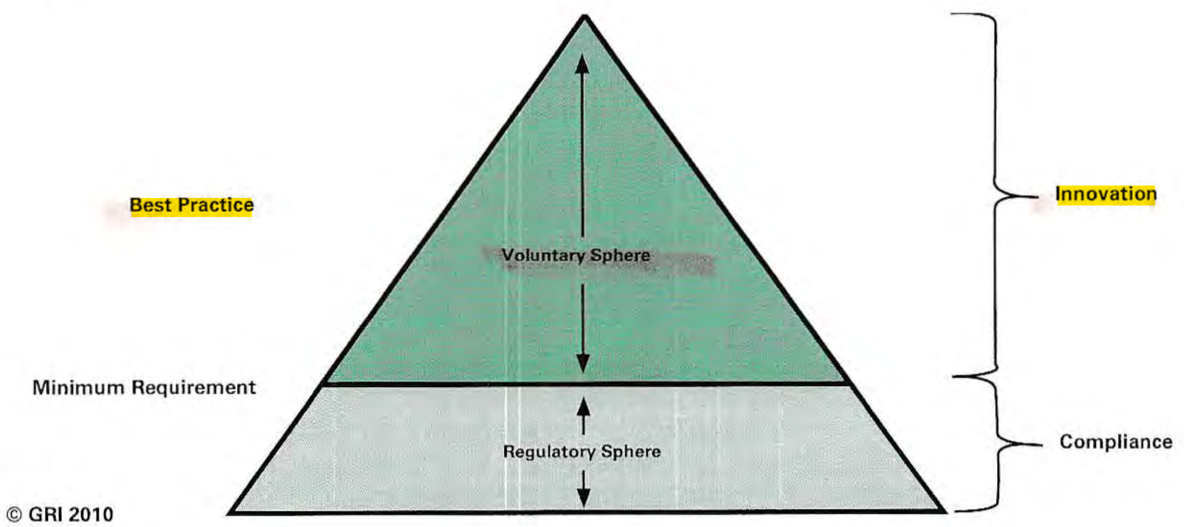


Figure 1: The interplay between the voluntary and regulatory spheres