Regulating Sustainability Reporting – Is a Mandatory Approach Better than a Voluntary One?

As the economy recovers and businesses respond, there is an opportunity for policymakers to strengthen sustainable development reporting standards that will benefit both companies and stakeholders.

Corporate sustainable development can be described as the practice of integrating environmental, social and governance programs into corporate structure without jeopardizing long term financial performance and compromising future global welfare. Simply stated, reporting sustainable development strengthens the link between the company and its stakeholders. The recent woes of the global economy and environmental and social disasters caused by company inattention have once again elevated the importance of sustainable development and reporting. In Canada, how to report sustainable development programs to stakeholders raises a debate of whether reporting guidelines are to be mandatory or voluntary. While both approaches could potentially achieve the same goal, each has distinctive drawbacks which may hinder the effectiveness of reporting. As both regulators and managers believe sustainable development reporting will be a major part of future business operations; the real question is by what means.

Why Report Sustainable Development Practices
A growing body of research shows a positive correlation between company sustainability and financial performance, suggesting the presence of a defensible business case for sustainable development. Reporting sustainable development practices is likewise important as it imputes and otherwise fosters a number of tangible and intangible benefits. Improved utilization of company assets, innovation of technologies, and greater appeal to socially responsible investors are among the top tangible benefits. Intangible benefits vary across companies but can be just as, or even more advantageous. A sustainably developed company that reports its progress can increase its industry credibility through leadership by example and reputational enhancement. The very act of communication to stakeholders further strengthens relationships, clarifies company objectives, and articulates the mode of operations.

Sustainability practices are sometimes stereotyped as being costly to report, confusing and highly qualitative with little true advantage. For instance, managers indicate that measuring the progress of sustainability year over year is difficult to report since many programs have little or no empirical indicators to compare. A certain level of scepticism is also present among senior management regarding the value of sustainability reporting as profitability continues to be the key measure for commercial success. However, the initiative of some companies in adopting sustainability reporting, as well as guidelines recently developed by various organizations have heightened the importance and value of corporate sustainability and addressed some of the perceived misconceptions. For example, the Global Reporting Initiative (GRI) developed guidelines that address communication and corporate structure challenges companies typically face. Globally, sustainability reporting adoption increased by 22% between 2009 and 2010, while the number of Canadian adopters increased by 53% over the same period.
Canada and Sustainability Reporting

In Canada, sustainability reporting is represented by a combination of mandatory and voluntary disclosures. Regulatory requirements to financial reporting mandate the disclosure of material environmental, social and governance factors. For instance, the Canadian Securities Administrators’ National Instrument (NI) 51-102 requires companies to report on material social and environmental policies, issues and liabilities in regards to their operations and performance. However, the determination of materiality is left to the judgment of the reporting company. Environment Canada enforces and maintains CEPA – 1999, an act which focuses on the monitoring of harmful substances toward the environment, preventing pollution and protecting human health by requiring companies to disclose any such information. The Federal Government has also demonstrated support for sustainability reporting internationally with the 2009 program aimed at the Canadian extractive sector overseas. However, there is evidence that existing regulatory disclosures of sustainability development do not necessarily meet information needs of various stakeholders and a lack of consensus over direct standards and purpose of sustainability reporting persist.

Mandatory Reporting vs. Voluntary Reporting Guidelines

Such events as the collapse of Enron in 2002 and the British Petroleum oil spill off the coast of Louisiana in the Gulf of Mexico in 2010 have left a general sense of distrust regarding corporate “self-regulated” reporting. In turn, mandatory disclosure of a company’s sustainability performance establishes accountability as well as identifies clear reporting objectives. Mandatory sustainability reporting also promotes socially responsible managerial practices. Countries with some form of mandatory reporting tend to have higher employee welfare, improved board supervision, greater prioritizing of environmental issues and less frequent cases of bribery and corruption across companies. Moreover, mandatory reporting advances the establishment and better use of sustainable development key performance indicators (KPIs), a vital tool for peer-to-peer comparisons. Measuring and reporting sustainable development KPIs also make it easier for management to link sustainability programs to corporate strategies. Currently, not many companies do so: some 67% of senior managers do not employ return on investment models in measuring output of sustainability initiatives due to unclear or ineffective measurables. Finally, a set of reporting standards that can be recognized internationally may present an opportunity for Canadian companies to expand globally by providing stakeholders with information comparable across companies and markets.

Contrary to mandatory reporting, voluntary reporting guidelines use competition, reputation and innovation as drivers to evoke sustainable development compliance. To stay competitive and build a strong reputation, companies may be compelled to disclose sustainability programs to reach new audiences. In 2008, 80% of all companies listed on the TSX reported some type of sustainability practice in their annual or standalone reports. Although this progress is positive, there is an immediate risk associated with voluntary reporting guidelines. For some companies, competition and reputation motives may not be strong enough to adopt sustainability reporting. Moreover, in challenging economic conditions, companies may choose to redirect resources toward essential operations and reduce or eliminate non-essential programs. In cases when sustainability reporting is voluntary, it may easily be seen by companies as non-essential and therefore be either reduced or fully abandoned. That would naturally not be the case under mandatory reporting. However, mandatory reporting has its own drawbacks, such as boilerplate style reporting to meet minimum requirements. Without proper monitoring and enforcement, reporting could be rendered meaningless and result in a waste of time and resources for all parties.

Establishing firmer minimum requirements to sustainability reporting may be an effective way to mitigate the shortcomings of both mandatory and voluntary approaches, but also improve the quality, standardization and comparability of sustainability reporting by Canadian companies. This may be particularly important as the world staggers through economic recovery and many companies are adjusting their business models to suit the current economic environment. Adopting an already recognized and established set of rules, such as GRI Guidelines 3.1, may be an effective way to achieve standardized sustainability reporting. At the same time, companies are encouraged to recognize the long term intangible advantages associated with sustainability practices. Sustainability reporting showcases a company’s efficiency in production, development of new technologies and resources, and overall operations to stakeholders. This enhanced communication may lead to improved brand equity, deliberate transparency, and increased stakeholder value.
Notes

1 There is no one single definition of sustainable development and the questions of what is to be sustained (e.g. climate, biodiversity, land productivity, clear water) and what is to be developed (e.g. equity, health, education, economic performance, family) are still subjects of the debate among different stakeholders. However, the concept of sustainable development is often understood as encompassing a spectrum of terms including corporate social responsibility (CSR), corporate citizenship, triple bottom line (TBL) of environment, economy and society, corporate ethics and corporate accountability.


3 In fact, measuring the practice of sustainability was identified as the largest concern among senior management according to the 2009 Canadian Financial Executives Research Foundation study – Corporate Sustainability Reporting in Canada. p. 33

4 GRI addresses three areas for complete sustainability reporting which includes a multi-stakeholder process, a record of accomplishment and independence.

5 NI 51-102F1 – MD&A Disclosures, NI 51-102F2 – Annual Information Form and NI 51-102F6 – Statement of Executive Compensation all address reporting requirements for social, environmental and governance issues that public companies are advised to follow.

6 Building the Canadian Advantage: A Corporate Social Responsibility (CSR) Strategy for Canadian International Extractive Sector


9 Internationally recognized sustainable development reporting guidelines and regulations include the Global Reporting Initiative (GRI), ISO standards 14000 series and 26000 series.

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