Mandatory Reporting: BSR Debates the Pros and Cons of Requiring Companies to Report on Sustainability

Interview with Dunstan Allison Hope, Managing Director, ICT Practice, and Blythe Chorn, Associate, Advisory Services, by Eva Dienel, Communications Manager, BSR

Originally Published in the *BSR Insight*: February 2, 2010

About BSR
A leader in corporate responsibility since 1992, BSR works with its global network of more than 250 member companies to develop sustainable business strategies and solutions through consulting, research, and cross-sector collaboration. With six offices in Asia, Europe, and North America, BSR uses its expertise in the environment, human rights, economic development, and governance and accountability to guide global companies toward creating a just and sustainable world. Visit www.bsr.org for more information.

At BSR's most recent conference in October 2009, Ben Verwaayen, the CEO of Alcatel-Lucent, spoke favorably about the need for mandatory sustainability reporting. At a breakout session later that same day, however, many corporate responsibility (CR) practitioners said they opposed mandatory reporting.

Even though many companies have been reporting on their CR performance for years, the growing interest from investors and policymakers has brought the question about whether CR reporting should be required to the forefront of debate in sustainability and regulatory circles. Over the last five years, six countries have passed legislation or issued directives mandating that companies include at least some CR data in their annual reports. But it's unclear whether these regulations are signs of a burgeoning trend, or just a short-lived experiment in promoting transparency.

In this Q&A, BSR's Dunstan Allison Hope and Blythe Chorn debate the pros and cons of mandatory reporting, with Hope in favor of regulation, and Chorn opposed.

What are your general arguments for or against mandatory reporting?

DAH: The first argument in favor is the sheer significance of addressing sustainability challenges today. Issues like climate change, human rights, and water security are priorities in the 21st century. We have to ask the question, why is the financial performance of companies given greater importance in law than sustainability performance?

Second, we need to consider fairness and responsibility: All companies should report, not just those that have volunteered. No company should be allowed to take a free ride by not disclosing sustainability information. This will become even more critical as companies from emerging markets such as China, India, and Russia become important global players.

Finally, reporting drives change in companies and raises the profile of sustainability issues in boards and among CEOs.

BC: There are a few reasons why mandatory reporting may not be the best move now.

First, there's the widespread concern that mandatory reporting would create a lowest common denominator in transparency. If governments set a number of key performance indicators that all companies must report on, companies may focus on simply checking the boxes of disclosure rather than thinking through which issues their stakeholders care about most.

This brings up a second challenge with mandatory reporting—that of materiality. It's hard to define a set of issues that are material to all companies across all sectors. At BSR, we have already seen this challenge play out with companies conducting voluntary reporting according to the Global Reporting Initiative (GRI)

G3 Guidelines. Although these guidelines set a strong baseline for reporting considerations, their implementation has led to recognition that sectors face unique sustainability challenges and reporting needs that require guidance. In response, the GRI has begun creating specialized sector supplements. In addition to following the specific requirements provided in the GRI guidelines, BSR encourages companies to define and report on the most material sustainability issues for their business. When considering mandatory reporting, it's challenging to imagine a framework or list of indicators that would be useful to companies and stakeholders across sectors.

Finally, we need to consider what mandatory reporting would mean for liability for disclosures, and how this could affect transparency. If governments require that companies report on certain topics, companies will be legally accountable for the accuracy of what they're disclosing, which may have a chilling effect on transparency. While governments and investors may be satisfied with a reduction in disclosures, other stakeholders will likely miss the opportunity for open discussion of challenges and failures as well as policies and positive performance.

What forms would mandatory reporting likely take? What, if any, are your concerns about those formats?

DAH: First, let me say what form it should *not* take: I don't think it should be a full GRI-based report or a long list of mandated performance indicators that every company would be asked to disclose.

I *do* think it should be principles-based—and one of those principles would be materiality: what's material to society as well as what's material to the business. It should request that companies disclose and provide discussion around sustainability risks and opportunities, and the actions the companies are taking to address those things.

Perhaps it would include core indicators that are so critical to sustainability that they are significant for just about every company in every industry of every size, with carbon-dioxide emissions and response to climate change being the prime examples.

With those minimum disclosures in place, it would be advantageous to allow space for companies to innovate. Look at financial statements: These include the disclosures every company is required to make, but they almost always are accompanied by a much longer company narrative that tells a more complete story.

I'm agnostic about whether sustainability reports should stand alone or be included as part of a larger annual report. The key point is that we need to shift from a model where mandated disclosures are based on what is "material to the company" into one where mandated disclosures are based on what is "material to the company and to society."

BC: To date, sustainability reporting requirements have not worked very well. Mandates have been vague and have set low standards. New mandatory reporting regulations would likely take one of two forms:

1. Integrated reporting (annual financial reports that include sustainability information)
2. Reporting against a set of standard indicators in a format determined by the company

I'll address concerns about integrated reports first. Because integrated reporting requires fitting sustainability data into existing financial reporting frameworks, transparency on sustainability performance often suffers in this approach. Reporting against a set of standard indicators is also problematic, primarily because of the materiality and “lowest common denominator” challenges I described earlier.

The topic of formats raises a key question: What is the primary objective of making CR reporting required? The two main challenges with voluntary reporting are data quality and the lack of comparability among data. Ideally, if reporting were required, we would see an increase in reporting on basic core indicators, as well as a maintenance of existing sustainability reporting that goes above and beyond regulations to meet other stakeholders’ needs.

But I don’t think we’ve figured out the right format or incentives to drive that vision. While a set of standard indicators could improve comparability, it wouldn’t necessarily improve data quality. In Denmark, for instance, the government has mandated that companies report on their CR policies and performance. In the interest of avoiding duplicative reporting, companies can refer to existing UN Global Compact Communication on Progress, but this doesn’t do much to improve the quality of reporting.

How would innovations in reporting be impacted by rules associated with mandatory reporting?

DAH: I don’t think much would change. I would expect that companies would seriously address disclosures related to legal requirements, but that wouldn’t stop them from doing all the other types of communications with stakeholders that they already do, from web 2.0 to engaging with stakeholders on issues that matter to them.

Look at the examples of environmental rules and regulations: Their existence doesn’t hamper innovation. The same applies to labor rules. Likewise, the GRI guidelines don’t stop companies from innovating and going beyond the guidelines. Simply because you raise the floor doesn’t stop you from doing innovative things—and to think it does indicates a strikingly pessimistic view of the innovative and creative abilities of global companies.

BC: I think there’s a distinct possibility that innovation would slow down. Mandatory reporting could lead to a shift in internal responsibilities for CR reporting. Currently, CR reporting is usually owned by CR teams, but if it’s mandatory, that ownership would likely switch to corporate affairs and legal teams. And then reporting would no longer be about openly discussing issues and gaining (positive and negative) stakeholder feedback; it would be about meeting legal requirements.

Also, mandatory reporting would take away some of the competitive advantage from strong transparency. We’ve heard companies ask why they should continue to invest so heavily in reporting if all of their peers begin to do it to some extent. Maybe we would see new mechanisms for transparency and stakeholder engagement emerge, but my sense is that mandatory reporting would remove the incentive to do anything more than comply with regulations.

DAH: Is it a bad thing if legal teams have more engagement in corporate responsibility? I’d welcome that shift. In fact, there are many more lawyers in business willing to be proactive on corporate responsibility than the stereotype presumes. I work with many of them!

How would mandatory reporting influence the way companies approach corporate responsibility—or would it matter?

BC: My sense is that mandated disclosures would remove the incentive for companies to explore material issues and force them to follow a checklist approach to transparency. I also fear that, for the sake of comparability, we would see a set of indicators that all companies are supposed to report on, and that would be where companies would make their investments, and where they would be most transparent.

DAH: For companies that are already practicing corporate responsibility, there would be only one major change: Mandatory reporting would raise the profile of corporate responsibility strategies to the board level. And companies that are not already reporting would have to put in place the people and processes to report on sustainability, so that would also raise the floor.

In response to the concern about the "checklist approach": I believe that the only quantitative indicator that would be defined as material and mandated for every company is carbon-dioxide emissions, and perhaps water and some type of waste or materials-based indicator. Other than that, I think it would all be principles-based.

It does raise a question about comparability, however, given that we've defined so few indicators, and that's where the continued development of professional standards and the GRI would be critically important.

Is it possible to mandate CR reporting now?

DAH: It's entirely within our capability to do it in the medium term, especially given our understanding of what a good report looks like and the principle of materiality. The biggest challenge to overcome will be defining the roles of the different legal frameworks around the world in which companies sit (e.g. the governing bodies, jurisdictions, industry and professional standards groups, and stock exchanges).

BC: We need to learn more about the assurance of corporate responsibility data before we can make sustainability reporting mandatory. This is something companies are starting to explore, but it's one of investors' biggest criticisms about sustainability reporting. Companies also need to trust the credibility of the data, because they would be held legally liable for it if reporting were required.

DAH: That's one of the secondary reasons why we should have mandatory reporting. It would use the stick of regulation to force the hand of companies and assurance providers to get their acts together for assurance policies.

If we go down this road, it would be absolutely crucial to have a proper discussion around legal liability, company law, assurance, and accuracy. I don't think this is the type of thing we can do tomorrow.