A POINT OF VIEW:

Why Corporate Social Responsibility (CSR) and Sustainability matter

"The quality of environmental data in sustainability reports remains appalling at times, even today," said Dr Ralf Barkemeyer, a lecturer in CSR at Leeds University and one of the team leaders. "In financial reporting to leave out an undisclosed part of the company in the calculation of profits would be a scandal. In sustainability reporting it is common practice."

Source: Guardian: Thursday 24 November 2011

Milton Friedman was right…

The economist Milton Friedman is often quoted - "The business of business is business". He also said "there is one and only one social responsibility of business–to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud".

From this we take a core message: If you are producing CSR or Sustainability reports, it is important to understand the business case for reporting, to know the risks, and to manage those risks. Consider carefully the audience and associated reporting standard(s).

Further, while reporting standards are important, simply stating compliance with a reporting standard is not adequate, and can be dangerous.

What you need to know…

While there are valid and important reasons to produce CSR/Sustainability reports, the information contained should be subject to independent review

- The world of CSR/Sustainability reporting is undergoing massive change
- Most CSR data is financial data, just packaged differently
- Many CSR reporting standards are little more than marketing standards
- Most CSR reports cover only a subset of the actual business. Disclosures in CSR/ Sustainability reports do not always mirror disclosures in statutory reports
- One activist with a smartphone can seriously ruin your day
- CSR/Sustainability reporting practices can be a bellwether of other reporting practices, good and bad

What you should do now…

- Internal Audit should revisit the risk universe and see how CSR/Sustainability fit; what risks are being missed, what controls are in place, and whether the program delivering against the promise
- Risk Managers need to ‘get in front’ of the CSR/Sustainability program, ensuring the range of risks are considered, targets are achievable, appropriate measurement and reporting is implemented, and that results (and unintended consequences) are reported and managed

Background

Most major companies produce CSR/Sustainability reports. Reporting is not new, and standards for such reporting are not new. Companies spend significant effort managing the message, but do so against a backdrop of weak and exploitable reporting standards.

It would be unacceptable (not to mention illegal) to 'fib' in an annual report or financial statement, or to tell only part of the story. Yet with CSR/Sustainability reports, it is common to select the subset of business activity (geographic, business line, product line, supply chain component) to include in reports. This leads to not only a willingness to misreport, it can incentivise misreporting.

Freedom to Report (pick your standard)

Companies can select the CSR/Sustainability Reporting standard that most closely fits their reporting desires, unlike financial reporting where the standard used is mandated by the jurisdiction in which the company is reporting. This creates a market for CSR/Sustainability reporting standards, with each standard differentiating itself based on the perceptions of what reporting companies wish to report – balanced against what consumers want to see in reports.

Audiences

It helps to consider the audiences when choosing a reporting standard. We need to consider a few audiences, because each has different needs:

1. General public / retail customers
2. Supply chain partners
3. Investors
4. Employees
5. Regulators

A (small) sample of CSR/ Sustainability reporting standards:

Global Compact (UNGC) The UN Global Compact is a US sponsored organisation that provides a framework for CSR reporting. There are currently over 8,000 organisational members of the Global Compact. The Global Compact has ten principles on which companies provide a 'Report on Progress'.

CDP (Carbon Disclosure Project) The Carbon Disclosure Project was launched in 2000 at 10 Downing Street, London. The CDP approaches thousands of organisations and invites them to provide a report on their carbon impact and plans to reduce carbon production. Organisations that decline to participate are 'named and shamed'.

GRI (Global Reporting Initiative) The GRI is one of the leading CSR / Sustainability reporting standards, with more than 1,000 companies and entities creating GRI compliant reports. To be GRI compliant a reporting organisation need only index their reports to the GRI set of indicators.

ISO 14000 As with other ISO standards, 14000 is primarily operationally focused, as opposed to the external marketing of some other reporting standards. ISO 14000 covers environmental management systems.

SASB The Sustainability Accounting Standards Board has been established with the objective of developing a set of sustainability and non-financial information standards of the same quality as those used in financial accounting. This will bring a new level of rigour to CSR/Sustainability report content.

DVFA/EFFAS The DVFA (German Institute of Investment Analysts) has developed a comprehensive list of KPIs for ESG (Key Performance Indicators for Environmental, Social and Governance). The standard has been endorsed and branded by EFFAS, the European Federation of Financial Analyst Societies.

Match the Standard to the Audience

Each audience has different, sometimes contradictory, information content, delivery needs and expectations. Any CSR / Sustainability reporting process should be operating to ensure that those needs are being addressed by the resulting reports or other communication mechanisms. A mis-match will reduce dramatically the effectiveness and benefit of the process.

1. General public / retail customers There is a growing acceptance that retail customers will purchase based on the perceived social conscience / 'green' credentials, as long as the product demonstrates equivalent quality at a competitive price. That is especially true today. Therefore it is important for a company to burnish its CSR credentials through any medium possible. There is also the need to be seen to be pro-active, just in case they are 'caught out' by a brand damaging event.

2. Supply chain partners Effective reporting sends messages to suppliers about expectations, and gives suppliers key messages about what might endanger the existing business relationship, especially any potential situations in which a supplier's PR problems might impact the company. Customers want to know that the company is following sound business practices, acting in a sustainable manner, and fundamentally reducing risks that may travel upstream. It can also demonstrate that sustainability practices are being applied to drive down costs.

3. Investors Investors and analysts are a (possibly 'the') legitimate audience. They want metrics; detailed information that supports and enables investment decision making. They want multi-year comparative information that can provide insights into the company's performance against peers. Analysts want tables of facts that span multiple years, and that clearly show future objectives and how those objectives will be achieved. Frequently reports written with the public in mind fail to provide adequate information for investors, and are dismissed by the analysts.

4. Employees Sometimes the primary audience is right there in front of you, the employees of the company. CSR / Sustainability processes and reports for employees are and should be focused on what the company is doing and the role of employees in individually making it happen. Further, in the 'war for talent', CSR / Sustainability credentials can influence choice the of employer.

5. Regulators Finally companies communicate with regulators, both directly and indirectly through public messaging. The use of the CSR / Sustainability to communicate support for and compliance with various standards is one such way. Reading the CSR reports for the building industry tends to be like reading a prose version of how the reporting company is ensuring compliance with various health and safety legislation, or preparing itself for compliance with GHG emissions standards.

Mapping Standards to Audiences

Primary Audience / Reporting Standard	Public / Retail	Supply Chain	Investors / Analyst	Employees	Regulators
UN Global Compact	√	√		▲	
Carbon Disclosure Project	√	√			▲
GRI	√	▲	▲		
ISO 14000				√	▲
SASB			√		√
DVFA			√		▲

√ Primary audience ▲ Secondary audience

The Risks:

We believe CSR / Sustainability reporting poses a number of significant risks to the organisation. We've grouped them into these four:

- **Reporting mis-match:** The biggest risk in this category is that there may be information in CSR / Sustainability reports that contradicts or is omitted from statutory or regulatory reports. Such a reporting mis-match could lead
- **Content:** Where there is a mismatch between the reporting standard used and the target audience, and the associated level of detail and assurance over content. Completeness, accuracy and timeliness of reported information varies by reporting standard used, and by the perceived needs of the target audience(s).
- **Assurance:** Where the process fails to provide adequate assurance to demonstrate to the audience(s) that the contents can be trusted. Too often assurance (under AA1000AS, ISAE3000 or PCAOB AT101 for example) may be limited in both scope and location. There is also the new ISAE 3410, Assurance Engagements on Greenhouse Gas Statements (effective 2013). It is our view that Stakeholder Councils are not able to provide assurance.
- **Delivery:** Is the CSR / Sustainability programme actually delivering the promise in terms of efficiencies, positive market perceptions, and increased (or retained) sales volumes?

Find the Business Case:

As with all significant investment, CSR / Sustainability reporting should be based on a business case. That business case should be focused on an audience, on delivery of a defined set of benefits, and with a level of assurance that provides the internal and external comfort required to trust the information reported.

The key recommendation…

We strongly recommend that companies with CSR / Sustainability programmes or that produce such reports should be mindful of the considerable risks associated with this seemingly low-risk activity. Risk Managers should be involved, and Internal Audit and the Audit Committee should seek and gain comfort that the risks are being identified and managed, and that controls over reporting are in place and effective. CFO involvement in the reporting process will add credibility to the information and confidence in the effectiveness of information collection and analysis processes.

To discuss the contents of this ***"Point of View"*** further, contact Richard Anderson or Daniel Roberts at Crowe Horwath Global Risk Consulting:

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