Issues related to sustainability represent the next frontier in corporate reporting. Broadly defined, sustainability reporting includes a company’s impacts, risks and opportunities from an environmental, social and governance (“ESG”) perspective. In recent years, an increased focus on sustainability-related issues has caused even the most mainstream investors to question whether companies are effectively addressing potential risks to their bottom lines as a result of their operational impact to the environment and society.

Given this increased scrutiny, it is unsurprising that a growing number of investors have been looking to companies to produce sustainability reports that accurately depict how they are managing and addressing sustainability concerns. In turn, companies are increasingly emphasizing the importance of sustainability. For example, in January 2012, a Sloan Management Review article reported that 70% of organizations stated that sustainability has a permanent place on the management agenda, and almost none said that they planned to reduce their commitments to sustainability.1 Further, in 2013, 86% of the executives surveyed said they believed that sustainability was necessary for their companies to be competitive in today’s market.2 Accordingly, many companies are taking actions designed to improve both their sustainability and the visibility of these actions.

For example, many companies are communicating their progress on sustainability-related initiatives through sustainability reports. The Global Reporting Initiative’s 2014 publication on trends in sustainability reporting found that this practice is on the rise. According to this report, 72% of companies in the S&P 500 produced a sustainability report in 2013, up from 20% in 2011.3 However, disclosure is growing in smaller companies (with revenues of less than $1 billion). In 2014, approximately 25% of these companies provided disclosure on sustainability-related information, compared to 15% in the previous year.4

Investors also view corporate sustainability positively. A 2010 survey found that 83% of investors stated that they believe environmental and social factors can have a significant impact on shareholder value over the long term.5 In addition, a 2014 report by the United Nations Principles for Responsible Investment found that $1 in every $6 in funds under professional management were invested using one or more ESG investment strategies.6 Thus, it is increasingly important that companies not only consider sustainability issues, but also communicate their sustainability strategies to investors. Sustainability reports are a key vehicle for communicating this information. However, as the number of shareholder proposals requesting sustainability reports grows and as companies adapt to rising investor demands through ever more complex forms of sustainability reporting, confusion has increased over what to report and the best way to report it.

REGULATION REGARDING SUSTAINABILITY REPORTING IN THE U.S.

For decades, U.S. companies have been required to report on some aspects of sustainability-related issues. For example, in their annual reports, companies must disclose certain legal proceedings that come as a result of employment, safety or environmental issues if related lawsuits could equal or exceed $100,000 or 10% of a company’s assets. In addition, since 1971 there have been movements to require greater disclosure of details related to environmental, social and governance issues.

---

These requirements include disclosure of details related to environmental liabilities and environmental administrative or judicial proceedings, establishment of internal controls to avoid fraud and inaccuracies in the reporting of government regulations and legal proceedings and guidance related to material risks related to climate change. More recently, the Securities and Exchange Commission (“SEC”) has required disclosure of issues related to the use of conflict minerals, payments made to foreign governments and equitable compensation. These mandates have arguably led to more robust reporting of sustainability-related issues. However, despite adherence to these disclosure requirements, many companies are still not clearly presenting how they have integrated sustainability into their business models, leaving investors unable to ascertain related risks and opportunities. A clear and integrated report is often referred to — and will be referred to here — as a “sustainability report.”

While the U.S. government does not currently require companies to release a sustainability report, several federal agencies have taken action to increase requirements and provide guidance to companies regarding sustainability disclosure practices. Most notably, in February 2010 the SEC issued an interpretive release to provide guidance on its nonfinancial disclosure requirements pertaining to climate change. While being careful to avoid airing opinions on the existence, intensity or sources of climate change, the SEC recommended that firms consider the potential legal, strategic, and direct impacts that climate change may have on firm operations. In a news release about the guidance, the SEC highlighted these potential triggers for disclosure:

- Impact of Legislation and Regulation: When assessing potential disclosure obligations, a company should consider whether the impact of certain existing laws and regulations regarding climate change is material. In certain circumstances, a company should also evaluate the potential impact of pending legislation and regulation related to this topic.
- Impact of International Accords: A company should consider, and disclose when material, the risks or effects on its business of international accords and treaties relating to climate change.
- Indirect Consequences of Regulation or Business Trends: Legal, technological, political and scientific developments regarding climate change may create new opportunities or risks for companies. For instance, a company may face decreased demand for goods that produce significant greenhouse gas emissions or increased demand for goods that result in lower emissions than competing products. As such, a company should consider, for disclosure purposes, the actual or potential indirect consequences it may face due to climate change related regulatory or business trends.
- Physical Impacts of Climate Change: Companies should also evaluate for disclosure purposes the actual and potential material impacts of environmental matters on their business.”

This guidance was commended by various environmental and investor groups as a huge step forward in improving the quality and consistency of climate-risk disclosure in the United States, which was weak and erratic. The guidance was not, however, issued without opposition. SEC Commissioners Kathleen Casey and Troy Paredes voted against the guidance, questioning its timing and whether the SEC was an appropriate body to address social and environmental issues. As one example of such regulation outside of the SEC, in December 2011, the Environmental Protection Agency (“EPA”)...
established mandatory greenhouse gas reporting requirements for large sources and suppliers in the U.S.\textsuperscript{10}

Global sustainability reporting trends also indicate the possibility of increased future regulation. Nineteen of the G20 nations have regulations requiring the disclosure of some social and environmental metrics by companies, and a third of the regulators on the board of the International Organization of Securities Commissions have introduced a sustainability reporting initiative.\textsuperscript{11} For example, in 2014, the European Union adopted a Directive on the disclosure of non-financial information, which, on a comply-or-explain basis, would require large public-interest companies with over 500 employees to disclose information on policies, risks and outcomes on sustainability-related issues, or to explain why the information is not being disclosed.\textsuperscript{12} Further, a 2013 collaboration of leading stakeholders including the United Nations Environmental Program, the Global Reporting Initiative and KPMG found that sustainable reporting requirements are on the rise globally, and predicted the continued expansion of these requirements by stock exchanges and governments.\textsuperscript{13}

\section*{REPORTING STANDARDS}

In response to piecemeal and often unclear or insubstantial disclosure of sustainability-related issues, there has been a widespread push by a number of players in the financial markets to standardize and heighten the quality of such reporting. The following is a discussion of those organizations and their roles in shaping the sustainability-reporting dialogue.

\textbf{The Global Reporting Initiative}

The Global Reporting Initiative (“GRI”) is the most popular sustainability-reporting framework, and reporting in accordance with the GRI is a common request in shareholder proposals seeking production of sustainability reports. The GRI framework enables companies to measure and report their economic, environmental, social and governance performance. Companies must establish an ongoing reporting cycle to monitor their sustainability performance and periodically provide senior management with information to help it shape company strategy and policy and improve performance. Since its formation, the GRI has released several iterations of its reporting guidelines, with the newest version, the G4 Guidelines, having an increased focus on reporting on sustainability issues that are material to a company’s business operations.

In recent years, reporting in accordance with the GRI guidelines has gained significant popularity. According to the GRI, from 2007 to 2011, the number of companies using the guidelines increased year-over-year from 21-67%.\textsuperscript{14} In 2012, 53% of S&P 500 companies had produced a sustainability report, with 63% of those adhering to GRI reporting standards.\textsuperscript{15} Furthermore, in 2013, 93% of the world’s largest 250 companies issued a corporate responsibility report, with 82% referring to the GRI Guidelines.\textsuperscript{16} A 2015 survey states that the number of S&P 500 companies referencing the GRI guidelines in their sustainability reports increased from 25% in 2013 to 31% in 2014.\textsuperscript{17}

\begin{itemize}
  \item \textsuperscript{10} Sarah White. \textit{“The Rising Global Interest in Sustainability and Corporate Social Responsibility Reporting.”} Thomson Reuters. October 5, 2012.
  \item \textsuperscript{11} Sustainable Stock Exchanges Initiative. \textit{“Sustainable Stock Exchanges 2014 Report on Progress.”} October 2014.
  \item \textsuperscript{12} European Commission. \textit{“Statement: Disclosure of non-financial information: Europe's largest companies to be more transparent on social and environmental issues.”} 2014.
  \item \textsuperscript{13} UNEP, Global Reporting Initiative, KPMG, Center for Corporate Governance in Africa. \textit{“Carrots and Sticks: Sustainability Reporting Policies Worldwide – Today’s Best Practice, Tomorrow’s Trends.”} 2013.
  \item \textsuperscript{14} Mike Wallace, Marjella Alma. \textit{“GRI Update: The Latest Trends in Sustainability Reporting.”} Global Reporting Initiative. February 13, 2013.
  \item \textsuperscript{15} Ernst & Young LLP, Boston College Center for Corporate Citizenship. \textit{“Value of Sustainability Reporting.”} 2013.
  \item \textsuperscript{16} Global Reporting Initiative. \textit{“Trends in External Assurance of Sustainability Reports.”} July 2014. (p. 15).
  \item \textsuperscript{17} The Conference Board, Inc. \textit{“Sustainability Practices 2015: Key Findings.”} 2015. (p. 4).
\end{itemize}
The International Integrated Reporting Council

Over the last several years, integrated reporting has gained increased popularity, with companies reporting their social and environmental impacts as a part of their annual report. According to the GRI, integrated reporting aims to help investors and management understand the links between a company’s financial results and its sustainability initiatives by presenting a comprehensive overview of the company’s strategy, governance, performance and prospects. An integrated report measures financial and nonfinancial performance as well as the relationships between them. The International Integrated Reporting Council (“IIRC”) was formed in 2010 by HRH The Prince of Wales and several international partners, and released its framework for integrated reporting on December 9th, 2013, which is designed to work with existing reporting standards, such as the GRI’s guidelines.18

Integrated reporting has gained traction in recent years. In 2010, some 12% of sustainability reports were identified by companies as “integrated reports.” There was an overall increase in integrated reports between 2009 and 2010,19 and, as of 2013, 1.4% of S&P 500 companies produced fully integrated annual financial and sustainability reports.20 According to a 2011 survey, the most commonly cited driver for integrated reporting among the world’s 250 largest companies was the desire to mesh corporate responsibility into the core business strategy.21

Although the vast majority of companies are not producing truly integrated reports, there appears to be a growing movement to produce sustainability reports that combine both financial and nonfinancial data. A 2010 report by KPMG said that only 20% of the world’s 250 largest companies produce a stand-alone corporate responsibility report. However, 27% of these companies include some form of sustainability reporting in their annual reports and 62% of companies that combine sustainability and financial reporting segregate condensed sustainability information into a special-purpose section of their annual reports. KPMG says this could “indicate the birth of a new era of ‘sincere’ [sustainability] reporting, where companies actively encourage readers to examine and segment corporate [sustainability] data to suit their unique needs and interests.”22

In an effort to improve the quality of integrated reporting and to set a standard for how companies can effectively report on financial and nonfinancial information, the International Integrated Reporting Council (“IIRC”) was formed in 2010 and, in 2012, it launched a two-year pilot program for integrated reporting. This program will ultimately result in development of an internationally accepted integrated reporting framework that fully encompasses financial, environmental, social and governance issues. In December 2013, the IIRC published its International Integrated Reporting Framework.

It appears that the IIRC has worked to ensure that its reporting framework is not in conflict with that of the GRI. On March 1, 2013, the GRI and the IIRC issued a memorandum of understanding of their intention to deepen their cooperation in the evolution of corporate reporting. In the memorandum, the IIRC indicated that it intends to encourage companies to use existing standards and guidelines, such as the GRI guidelines, in conjunction with its reporting framework.23 Further, one of the G4 development objectives is to offer guidance on how to link the sustainability reporting process to the preparation of an integrated report aligned with the guidance to be developed by the IIRC.

THE SUSTAINABILITY ACCOUNTING STANDARDS BOARD

The Sustainability Accounting Standards Board ("SASB") was established as a non-profit organization in July 2011 for the "purpose of establishing industry-based sustainability standards for the recognition and disclosure of material environmental, social and governance impacts by companies traded on U.S. exchanges."24 SASB has worked with investors, companies and industry associations to determine which metrics are material and develop accounting and auditing protocols to establish consistent, industry-specific disclosures.

SASB’s aim is for the SEC to require disclosure of its standards in companies’ 10-K filings. As such, the SASB disclosures are limited in scope and cannot be adopted by companies domiciled outside the United States. According to SASB, its industry-specific standards are meant to “complement…financial accounting standards, such that financial fundamentals and sustainability fundamentals can be evaluated side-by-side to provide a complete view of a corporation’s performance.”25

To ensure that sustainability disclosure is tailored to the company making the disclosure, and therefore material to its operations, SASB has developed specific sustainability-related indicators for each sector. These indicators are developed in collaboration with stakeholders and then subjected to a 90-day public comment period. In September 2013, SASB announced that 10 companies will be selected for its pilot program, a three-year process in which SASB, and its partner, Bloomberg, will work on Form 10-K preparation, business process reengineering, data management and verification and investor relations.26

A major issue with the SASB’s proposed actions is ensuring corporate compliance, particularly when there is no regulatory mandate driving the initiative. Given that SASB requires companies to report on these issues in their Form 10-K filings, companies are likely to face a bevy of problems and roadblocks. Given that regulatory documents are subject to significantly more scrutiny than a stand-alone sustainability report, legal counsel and senior executives could be unwilling to present information that is not required by law, particularly when such information could potentially elicit negative reactions from stakeholders.

Notwithstanding this issue, adoption of SASB’s indicator disclosure requirements could be a huge boon for investors and the reporting company, as the disclosure has the potential to provide investors with clear, comparable information. However, it appears that there is a still a way to go in achieving this transparency. In 2014, SASB found that 37% of disclosures within a sample of 10K filings consisted of boilerplate information, considered to be too general to effectively evaluate company performance, and that 10% of the disclosures used metrics. SASB argues that these findings demonstrate a significant need for improvement in the quality of corporate disclosure, particularly in the use of quantified metrics.27

ACADEMIC EVIDENCE REGARDING SUSTAINABILITY REPORTING

Recent academic evidence has found benefits from corporate sustainability initiatives. For example, companies that are ranked highly for sustainability have fewer capital constraints than their peers.28 This could be because sustainable companies have found efficiencies that lead to returns or because sustainable companies have lower capital costs, as found by a 2012 Deutsche Bank

25 SASB. “Vision and Mission.”
Another 2012 study found that resource-efficient companies (defined as those that use less energy and water and create less waste in generating a unit of revenue) were found to produce higher investment returns than their less resource-efficient peers. Further, these resource-efficient companies also display higher levels of innovation and entrepreneurship. Sustainability initiatives can also give businesses a reputational edge, which could lead to a larger or more committed consumer base. For example, a 2012 survey found that approximately 8-10% of British consumers reported awareness of environmental problems and their power as consumers to choose the right products. Corporate leaders are increasingly aware of this opportunity, with 76% of CEOs believing that embedding sustainability into core business areas will drive revenue growth and 84% of CFOs believing that sustainability is linked to financial performance. Even companies that perhaps reluctantly engage in sustainability-related activities may reap benefits from them. A 2012 study found that a large institutional shareholder’s successful intervention in corporate social responsibility increased a company’s share price by an average of 4.4% a year. Share price increases have also been found to be positively associated with ESG ratings and with companies’ inclusion on socially-responsible indices. Other research has found historical links between sustainability and corporate performance. For example, a 2003 meta-study covering 33,878 observations over 30 years found consistent correlation between corporate social responsibility and corporate financial performance. Further, a 2012 study found that companies that voluntarily adopted sustainability policies by 1993 significantly outperformed their peers, both in terms of stock market and accounting performance, by 2009.

Given the benefits associated with sustainable business activities, it is important that companies clearly communicate their efforts through production and dissemination of a sustainability report. Production of this report may have benefits in and of itself. For example, a 2011 Harvard study found that mandatory sustainability reporting has a positive impact on socially responsible management practices. Specifically, the study found that sustainability reporting leads to (i) an increase in social responsibility of business leaders; (ii) a prioritization of sustainable development; (iii) a prioritization of employee training; (iv) more efficient supervision of managers by boards; (v) increased implementation of ethical practices by firms; (vi) decreased bribery and corruption; and (vii) improved managerial credibility within society. The study suggests that disclosure of ESG information not only increases transparency, but also changes corporate behavior, as sustainability reporting forces companies to manage these matters effectively in order to avoid disclosure of poor ESG performance to stakeholders.

Sustainable business operations and reporting on those operations can also improve companies’ stakeholder relationships, particularly those with their employees. In a 2012 Bain & Company survey of about 750 employees in Brazil, China, India, Germany, the UK and the U.S., roughly 66% of respondents stated that they cared
more about sustainability now than three years ago and that sustainable business is very important to them. Given that a significant portion of employees care about the sustainability efforts of the companies at which they are employed, companies should consider a focus on related issues as potentially beneficial for recruitment and retention. In fact, a 2011 Ernst & Young survey found that 18% of companies that produced a sustainability report cited employees as the primary audience, and similar 2013 survey found that 30% of companies producing sustainability reports experienced a directly related increase in employee loyalty. However, employees are not the only stakeholder group that views sustainability reports. In the same 2013 survey, more than 50% of companies that issued sustainability reports stated that it had helped them improve their firms’ reputations with those outside of the organization.

Companies producing sustainability reports may realize financial benefits in addition to, and in part as a result of, the less-tangible effects. A 2012 review found that S&P 500 companies that consistently report sustainability impacts have a five-year annualized return of 3.9%, almost double the 2% five-year annualized return of companies without consistent sustainability reporting.

Other researchers have found further benefits to sustainability reporting. A 2013 Ernst & Young and Boston College Center for Corporate Citizenship survey found that companies producing sustainability reports find significant benefits, including: (i) increased consumer loyalty; (ii) increased employee loyalty; (iii) more efficient decision-making processes, (iv) increased resource efficiency; and (v) an improvement in monitoring and managing long-term risk.

---

41 Ernst & Young LLP, Boston College Center for Corporate Citizenship. “The Value of Sustainability Reporting.” 2013.
43 Ernst & Young LLP, Boston College Center for Corporate Citizenship. “The Value of Sustainability Reporting.” 2013.
44 Ernst & Young LLP, Boston College Center for Corporate Citizenship. “The Value of Sustainability Reporting.” 2013.

---

OBSTACLES TO SUSTAINABILITY REPORTING

Sustainability reporting is a complex process given the many challenges in assessing nonfinancial indicators of performance. Unlike financial reporting, much of the data and metrics used in sustainability reporting is unregulated and can be often subjective. ESG criteria, for example, can vary across companies, industries and countries. In fact, many companies report data-related issues, such as availability, accuracy and completeness of data, as the main challenges in the reporting process.

Given the inherent challenges in identifying and collecting the sustainability-related data necessary for publication of a sustainability report, it is unsurprising that a number of companies have determined to not disclose extensive sustainability-related information. Additionally, companies may face internal conflicts about production of a sustainability report, as corporate lawyers may be concerned about disclosure of sensitive information. Also, many companies are facing so many disparate requests for disclosure of various sustainability-related issues from different shareholder groups, they could be experiencing disclosure overload. These issues were echoed by Kenneth A. Bertcsh, former president and CEO of the Society of Corporate Secretaries & Governance Professionals, who stated that “if it is material, after all, it should already be in the 10-K... The disclosures companies are making are already voluminous, and bringing in new information that in actuality is intended for a completely different audience does a disservice to investors. Already rule bound, most companies find reporting lending itself more to lawyers writing documents than effectively communicating with shareholders.”

Finding the resources, interest and internal management support necessary for production of a sustainability report appears
to be more feasible at larger companies, according to current statistics. There is also often a significant gap between the sustainability-related information reported by large companies and that reported by smaller companies. According to a 2013 study, companies with more than $2 billion in market capitalization are nearly 10 times more likely to engage in quantitative sustainability reporting, relative to their smaller peers.\(^{46}\)

A significant problem with disclosure, according to a 2012 Deloitte research report, is that “there is often a disconnect between what ESG information companies disclose to their stakeholders and the data that actually drives management and investment decisions.” Still, the report argues that disclosure of ESG data can be as crucial and informative as disclosure of financial data, and that companies should focus on a small set of material performance indicators while leveraging input from all key stakeholders in order to move forward on valuing and reporting ESG data in a pragmatic and cost-effective manner.\(^{47}\) In fact, a recent Accounting Review report linked company performance against materiality and the rating of sustainability issues. The report found that companies with good ratings on material sustainability issues outperformed companies with lower ratings. However, companies that have high ratings on immaterial issues showed no observable improvement in performance over peers with poor ratings on the same topics.\(^{48}\)

A 2015 report finds that inconsistent corporate disclosure on sustainability issues, including inadequate assessments of the materiality of ESG issues, presents a challenge for determining the implications of an investment, which in turn may prevent investors from fully integrating sustainability issues into their decision making process.\(^{49}\) In a 2015 survey of more than 200 institutional investors, 38.8% of investors said that companies do not adequately disclose the ESG risks that could affect their business models, and that they should disclose these risks more fully.\(^{50}\)

**CONCLUSION**

Sustainability reporting is clearly a growing trend in the U.S. and across the globe. As such, we believe that companies should ensure that they are clearly recognizing and communicating the risks and opportunities associated with sustainability-related issues in a way that mitigates risk to shareholders. While we recognize that there is still no definitive empirical evidence regarding the impact of voluntary sustainability reporting, we believe that production of a sustainability report can be an important signal for a company’s commitment and willingness to ensuring that its operations are managed responsibly from a social, environmental, governance and financial perspective. We expect that, as the trend toward more and better sustainability reporting increases, companies will increasingly face investor pressure to ensure that their reporting is consistent with investors’ growing expectations for more comprehensive and transparent disclosure. We believe that investors should monitor companies to ensure that they are adequately addressing sustainability-related risks, as often these risks can have very real financial implications for companies.

We recognize that sustainability reporting is often a helpful tool in this monitoring process and will review proposals requesting sustainability reports on a case-by-case basis, taking into account the following factors: (i) the direct, legislative, regulatory, legal and reputational risks associated with

---


\(^{50}\) Ernst & Young LLP. “Tomorrow’s Investment Rules 2.0.” 2015. (p. 19).
the Company’s operations; (ii) the relevant company’s current level of disclosure and oversight of sustainability issues; (iii) the level of sustainability disclosure available at the firm’s peers; (iv) the industry in which the firm operates; (v) the level and type of sustainability concerns/controversies at the relevant firm, if any; (vi) the level of flexibility granted to the board in the implementation of the proposal; and (vii) the time frame within which the relevant report is to be produced.