Federation of European Accountants
Fédération des Experts comptables Européens

July 2009

Call for Action

Sustainability Disclosures in Financial Information Can Be Improved

Call for Action

On 29 April the European Parliament hosted a Roundtable discussion on "Sustainability Disclosure" jointly organised by Eurosif (European Sustainable Investment Forum) and FEE (Federation of European Accountants) with a wide range of participants in order to identify how sustainability information in annual reports can be further improved, not only for accountability purposes but more importantly to drive change in corporate behaviour. The debate resulted in various calls for action, the main ones are reproduced below and reference should also be made to the Appendix: A Summary Note on the Roundtable.

In the current climate of financial and economic crisis, FEE and Eurosif wish to raise the strategic importance of sustainability disclosures in order to provide financial information in a more comprehensive and meaningful way and to increase transparency, as surveys show that sustainability disclosures are often limited or not existing in the annual reports. The number of companies disclosing sustainability information in general - in sustainability reports or elsewhere - has nevertheless grown significantly in recent years.

Greater transparency can play a role in helping to restore trust in business. Better information is critical in facilitating well informed decision-making that takes account of risk and other factors. Increasingly investors are demanding more developed and sophisticated reporting on non-financial issues. Non-financial information helps put historical performance into context and portrays the risks, opportunities and prospects for future growth. Non-financial information including sustainability information plays an important role in mitigating short-termism that until recently dominated financial analysis and valuation.

Sustainability disclosures are integral to reporting: sustainability should be embedded at the core of the company's strategy and decision making. It is regrettable that the disclosed sustainability related KPIs (Key Performance Indicators) are often not yet linked with the financial statements. Sustainability related KPIs form an essential factor in investment decisions made by analysts. It is therefore important for companies to have guidance on how to identify relevant KPIs.

Calls for Action

1. Lessons from the crisis: There are lessons to be learnt from the financial and economic crisis in relation to management responsibility, integrity and accountability. These principles require high quality, reliable information incorporating sustainability disclosures in order to allow stakeholders to assess the risks and strategic opportunities in the context of future developments.

    - It would be beneficial to disclose future oriented narrative sustainability information including risks, opportunities and predicted performance as well as past performance data and commentary. The annual report should therefore include forward-looking information both in terms of financial and non-financial information to give readers an idea of where the company sees itself in the future.

    - It is important to have a globally understood language that enables stakeholders to assess how companies are performing and any risks or opportunities. The discussion on how to make such sustainability disclosures measurable needs to continue.

2. The annual report is not the only source of information available to stakeholders: there are press releases, articles and interviews, company websites, road shows etc. However once a year it is helpful to have a calibration and confirmation in the form of sustainability disclosures within the annual report.

3. Non-financial KPIs provide useful information about the way the company is managed and should be understood and connected to the company's performance by stakeholders.

4. Ideally companies that are transparent on sustainability:

    a. Need to be rewarded by mainstream as well as socially responsible investors in that the "new honesty" needs to be reflected in the tangible and intangible value of the company. Research needs to be done into how to include sustainability considerations in such valuation of the company;

    b. Need to get easier access to finance through government intervention.

5. Reporting initiatives such as GRI provide a wide range of possible KPIs, but companies tend to select a specific set of them for their own reports. It would be helpful to have a core set of general key indicators that all companies use to enhance comparability. This core set should be supplemented by sector specific KPIs. In the absence of such a core set, the company needs to explain why the chosen KPIs are relevant to the company. In addition, specific principles for the selection of KPIs should be developed.

6. Making basic, specific disclosures mandatory should be investigated, for example as part of corporate governance codes. Companies can then build on such disclosures. A "comply or explain" approach could be applied in that companies explain why they are not providing the basic disclosures.

7. Responsible companies should automatically provide sustainability disclosures as a matter of course to ensure maximum transparency and accountability, regardless of whether such disclosures are mandatory or not.

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About Eurosif

EUROSIF, the European Sustainable Investment Forum, is the pan-European network whose mission is to **address sustainability through the financial markets.** Eurosif works as a partnership of the national Social Investment Forums (SIFs) within the EU and with the support and involvement of Member Affiliates. Recognised as the premier European forum for sustainable investment, Eurosif's Member Affiliates are drawn from leading pension funds, asset managers, NGO's, trade unions, academic institutes and research providers, together representing assets totalling over €1 trillion. The key benefits that Eurosif affiliate members receive include ground-breaking research, EU interfacing, and European-wide initiatives that integrate ESG issues into the financial services sector. For more information, visit www.eurosif.org.

About FEE

FEE (Fédération des Experts comptables Européens – Federation of European Accountants) represents 43 professional institutes of accountants and auditors from 32 European countries, including all of the 27 EU Member States.

In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 500.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent, and sustainable European economy. To learn more about FEE and about the accountancy profession in Europe, read the FEE 2008 Annual Review, downloadable from our website www.fee.be.

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APPENDIX

FEE/ EUROSIF European Parliament Roundtable on Sustainability Disclosure

Summary Note - 29 April 2009

The FEE/EUROSIF roundtable was held with the following participants:

Guest Speakers:

Hans van Damme	FEE President
Robin Edme	Eurosif President
Richard Howitt	MEP, European Parliament Rapporteur on Corporate Social Responsibility

Panellists:

Paul Druckman	Chairman, FEE Sustainability Policy Group
Brice Aveline	GDF Suez
Frank Curtiss	Railpen/ICGN
Ralf Frank	EFFAS, Managing Director of DVFA
Gaëtan Herinckx	Dexia Asset Management
Ernst Ligteringen	GRI Chief Executive
Chiara Mio	Member, FEE Sustainability Policy Group
Pedro Ortún	European Commission, Director DG Entreprise
Susanne Stormer	Novo Nordisk
Stéphane Voisin	Crédit Agricole Cheuvreux

Introduction

The FEE President, Hans van Damme, opened the Roundtable by welcoming the participants. His special thanks went to Mr. Richard Howitt, European Parliament Rapporteur on Corporate Social Responsibility for hosting the Roundtable. He introduced the topic of the Roundtable as being a very relevant subject in the current framework of discussions around the economic crisis and noted the support for sustainability disclosures to be integral to reporting and underlined that sustainability should therefore be embedded at the core of the company's strategy and decision making.

The Eurosif President, Robin Edme provided some additional introductory comments, mainly that financial reporting is key in terms of embedding sustainability in the company's management processes.

He noted Eurosif's position on this topic as presented in a recent Eurosif statement of 16 April 2009, emphasizing the need to consider enhanced regulation that encourages all participants in European capital markets to focus greater attention towards long-term performance. He called on European Institutions to mandate disclosures of Environmental, Social and Governance (ESG) data, underlining that such reporting should be principles-based and use a limited number of standardised Key Performance Indicators (KPIs), some of them being sector specific. The FEE Discussion Paper launched in December 2008 on Sustainability Information in Annual Reports also indicated that sustainability disclosures could be improved.

In his opening speech, Richard Howitt noted the importance of ensuring that the EU debate on CSR and sustainable disclosure be embedded in a global context in particular in light of competitiveness. Europe has made real progress in the CSR area. Regarding disclosure and in particular the question developing indices to which business signs up, he explained that it might be appropriate to acknowledge that there is no one unique answer. He emphasized the need for multi-stakeholder involvement. He pointed at the OECD Multi-National Enterprises Guidelines, UN Human Rights Council and Global Reporting Initiative (GRI) as valuable and globally accepted instruments to build upon pronouncements. He noted the European Parliament's support for mandatory reporting on sustainability. The accountancy profession has been and remains an important driver in this debate. He suggested three ways of persuading companies to disclose sustainability information:

- Highlighting that sustainability issues can have an impact on the financial bottom line of companies,
- Raising public awareness to achieve greater responsibility for environmental impacts,
- Motivation through legislation; while some elements are already in the Modernisation Directive, the envisaged amendments of the Fourth Directive might be a good time to enhance the framework of sustainability disclosure.

Finally, he emphasised the urgency to act now to change current practices however difficult it might be. In particular as a result of the current economic downturn sustainability issues should not be ignored. Thought and effort should be put into implementing existing standards and frameworks rather than setting standards and creating guidance that we already have.

The key questions debated at the Roundtable were the following:

- Is there a need for sustainability disclosures?
- What should be the contents of sustainability disclosures?
- Can sustainability disclosures play a role in relief from the crisis?
- Should sustainability disclosures be mandatory and legislated for?

The main suggestions of the Roundtable are the following:

Is there a need for sustainability disclosures?

- There is a need for a globally understood language to achieve transparency, comparability and accountability. Sustainability reporting can be considered as work in progress and needs to be taken forward globally.

- There is first of all a need for sustainable and responsible organisations. ESG disclosure is a necessary management tool, rather than an objective as such. It is a communication tool for both internal and external stakeholders. Non-financial KPIs can provide useful information on the way companies are managed. However, the question can be raised whether needs in terms of sustainability information are the same for all stakeholders. Of the over 40.000 large companies within the EU, only some 300 to 500 have taken serious initiatives in sustainability disclosure. The European Commission may have an important role to stimulate disclosure, but market players have a much more important role on the demand side.

- There should be a business case; even responsible organisations cannot be expected to be driven only by the public good. The top management should feel that this is “the right thing to do” and that embedding sustainability into the organisation brings added value. This would not only be in terms of brand value but also by enabling enhanced risk assessment. In addition, investors welcome more information about the risk approach including sustainability considerations.

- The annual report is not the only source of information available to stakeholders: there are press releases, articles and interviews, road shows etc. However it is helpful to have once a year a calibration and confirmation in the form of sustainability disclosures in the annual report. The discussion on how to make such sustainability disclosures measurable needs to continue: It is a challenge to quantify the benefits; it is easier to quantify the costs although it is difficult to internalize externalities. Non-financial KPIs provide useful information about the way the company is managed. Some of the advantages of providing disclosures in the annual report include discussion at the general meeting of shareholders and ensuring board involvement.

What should be the contents of sustainability disclosure?

- The survey which FEE undertook as part of its Discussion Paper showed large differences in sustainability disclosures between countries across Europe. These differences are mainly due to cultural differences and the nature of the industries, rather than to legislation. The application of KPIs varies. GRI provides a wide range of possible KPIs, but all companies select a different set of KPIs. It would be helpful to have a core set of key indicators (some 10 to 12 indicators) to enhance comparability. The selection of KPIs should not only be driven by stakeholders' demands but also by the philosophy of companies. Some argue that disclosing proper KPIs could result in revealing a "competitive advantage".

- Management should not only be evaluated based on financial performance measures. Sustainable performance needs to play an increasing role in evaluation and remuneration. Rewarding management according to sustainability objectives could be a driver for enhanced awareness on sustainability issues and more transparent disclosures.

- The quality of sustainability information can be improved by independent assurance.

- The management needs to understand sustainability and be able to convince the Board, they need to speak the "language" of the Board and bring sustainability within the "language" in order to be successful.

- Sustainability reporting standard setting is developing. GRI has com a very long way through the globally used G3 guidelines. It should not be forgotten that there is over a century experience with financial reporting with related development of the conceptual thinking process. There is a learning curve and a gradual development process to be aimed at. Financial reporting demonstrates that developing a framework for sustainability reporting is achievable. However, this process will take some time.

- The demand for disclosures should be investigated particularly if it is considered making certain disclosures mandatory, in particular what type and frequency of disclosures should be provided.

- It might be difficult to mandate specific KPIs: there are different needs among investors and other stakeholders. Because of this, it might be preferable to set the underlying principles and develop guidance on this basis. In this respect, it might be useful providing a list of KPIs that could be used as a best practice example. This could be a non-exhaustive list that could also be adapted for developments in stakeholders needs.

Can sustainability disclosures play a role in recovering from the crisis?

- There are lessons to learn from the financial and economic crisis in relation to management responsibility and moral and intellectual honesty supported by high quality, reliable information including sustainability disclosures in order to allow stakeholders to assess the risk in the context of future developments, including climate change. Companies should be willing to be part of the solution instead of being seen as causing the problem. This requires a globally understood language that enables stakeholders to assess how companies are performing.

- The crisis requires increased transparency on risks including enhanced information on the company's strategy. Investors are not looking for more information but for more relevant and credible information. Reference was in this respect to the seven recommendations of the ICGN (International Corporate Governance Network) Statement and Guidance on Non-Financial Business Reporting. Non-financial risk should not be regarded as extra financial but as main governance risks which may have financial implications. Survival and better disclosure are not mutually exclusive.

- A question that needs to be addressed is how companies are to be rewarded when they are doing well in relation to sustainability disclosures. Such rewards need to come from the investors and the new honesty needs to be reflected in their value. There should also be incentives for such companies in terms of access to finance, etc. Providing increased transparency on sustainability should be rewarded by investors and could lead to a 20% spread compared to a similar company that is not transparent on its sustainability commitments.

- There are different ways to communicate on sustainability. This could include investors meetings and employee meetings in order to adapt the communication to the audience.

- Important is the process behind sustainability disclosure and how this process is managed. This process needs to be fully embedded in the reporting practices of the company and address relevance, transparency and continuity. Effective tools are needed. Just as with financial statements, the fact that there is a process in place for reporting is already a positive element; it requires for instance the process of collecting data and the implementation of internal controls and management's involvement.

- The company needs to address the basic question what to do to stay in business in the long run. Are there ways to create incentives for investors to have longer term investment horizons? A longer term view might help in the implementation of effective sustainability disclosures. In financial reporting one year comparatives are provided; in sustainability disclosures a longer reference period may need to be provided, for example of 5 years in order to see the real development.

Should sustainability disclosures be mandatory and legislated for?

- Given the developments in sustainability reporting over the last years there is a general expectation that larger companies report on KPIs. If companies are not reporting on sustainability issues, they are expected to explain why: i.e. why sustainability issues are not relevant to the company. This so called "comply or explain" approach may be a good way forward in mandatory reporting on basis of a core set of KPIs.

- Mandating sustainability disclosures in some way may be necessary if one considers that the voluntary approach in place over the past 15 years has not resulted in a common reporting. However, it should be realised that it took a long time to develop a global financial reporting framework and global financial reporting standards (IFRS).

- There is no one size fits all reporting. A proper infrastructure is needed on basis of which specific reporting can be developed. Reporting may include interactive reporting. Companies should not only provide boiler plate information: words need to be turned into action.

- Taking French law (loi NRE) as an illustration, what is needed is a change of culture or a better approach to risk management to achieve progress beyond CSR reporting.

- It can be questioned if focusing on listed companies is appropriate for sustainability penetrating the market. SMEs should not be excluded; however they should only be subject to simplified requirements. Leading companies have easy access to sustainability standards and guidance whereas smaller companies have not. Politically it may be difficult to require disclosures for SMEs in a time where everybody is focused on simplification and reduction of administrative burdens. How can one change the paradigm and raise the awareness about sustainability without including SMEs?

- Companies need to focus on certain stakeholders: the shareholders/investors may need to be the first audience. The more stakeholders envisaged, the greater the risk that the disclosures will be excessive. Overregulation should be avoided.

- The European Commission will continue to work on the area of sustainability disclosures and intends to organise a series of workshops with relevant stakeholders to facilitate better coordination of initiatives on the subject, with a focus on exploring the development and appropriateness of a set of KPIs that could form part of European Commission's proposals by mid 2010.

- Companies should feel obliged to provide sustainability disclosures, regardless from the fact whether such disclosures are mandatory or not.

QUESTIONS AND STATEMENTS ADDRESSED

A. Is there a need for sustainability disclosures?

A.1 Sustainability disclosures are very useful when sustainability is embedded as a core part of the company's strategy and decision making. Sustainability disclosures are more than a communication tool.

A.2 Sustainability related KPIs form an essential factor in investment decisions made by analysts. However, do disclosures in the annual report matter or do analysts have other resources?

B. What should be the contents of sustainability disclosures?

B.1 A recent FEE survey shows that sustainability disclosure reporting can be improved. Disclosed information is often limited to what is readily available. How come?

B.2 The disclosed sustainability related KPIs are often not linked with the amounts in the financial statements. Will this make the sustainability related KPIs of less interest? How should financial reporting and sustainability reporting be connected in general?

B.3 The concept of materiality is often used as a criterion to determine what should be disclosed. How to decide what is material and what is not? How should the key KPIs be identified? When is a performance indicator a key performance indicator (KPI)? Are KPIs sector-specific or generic, or both? Should the basis for selection of KPIs be disclosed?

B.4 The Modernisation Directive does not indicate which core KPIs on environmental and employee related matters are to be disclosed. Is further guidance needed, or would this put too straight a jacket on companies?

C. Can sustainability disclosures play a role in recovering from the crisis?

C.1 In the current crisis climate, sustainability and sustainability disclosures are of lesser importance for companies. Their first aim is to survive.

C.2 What role can sustainability and sustainability related disclosures play in avoiding a future financial and economic crisis?

D. Should sustainability disclosures be mandatory and legislated for?

D.1 The European Commission is currently consulting on amending the Fourth and Seventh Directive, including on notes to the accounts. It is stated that "The disclosure requirements are constantly critisized by SME representatives for creating a lot of administrative burdens without creating additional value for users". The consultation paper provides a tentative listing of nine essential disclosures for small entities. None of these disclosures relates to sustainability. Sustainability information is not essential to get a true and fair view of the financial position or performance of a company.
The Modernisation Directive requires the reporting of KPI relating to environmental and employee matters for large companies. Small and medium sized companies can be exempted based as a Member State option (option applied in at least 22 Member States).

D.2 What are the lessons learnt from the French law NRE (2001) mandating listed companies to report on how they take into account the social and environmental impact of their activities: positive for the companies? For the investors? What could be reproduced at the European level, what could be improved (i.e. principle-based reporting vs. detailed and prescriptive reporting approach)?

D.3 Should there be a further requirement for listed and large companies to disclose environmental, social and governance data beyond the already required KPIs on environmental and employee related matters?

D.4 What role could the European Commission have in promoting disclosure of sustainability information? Is the annual report the right place for sustainability disclosures?