Still Evolving: Meeting the Challenges of Non-Financial Disclosure

Non-financial disclosure demonstrates the true value of corporate responsibility to stakeholders. The challenge has been developing the information in a way that has meaning for decision-makers and stakeholders.

Non-financial reporting has been evolving for over two decades now, growing well beyond addressing environmental issues to include social and governance aspects of doing business. It has been an evolutionary process which began with informing investors of environmental issues and is now trending towards integrated reporting in which financial and non-financial reporting is combined. There are good reasons too. Environmental, social, and governance (ESG) factors, or sustainability factors, have a direct impact on financial performance. It is also true that the networked world in which businesses operate has led to a myriad of stakeholders exerting pressure on them to inform investors, consumers, NGOs, regulators and communities about corporate responsibility efforts. Still evolving, the biggest challenge now is establishing and adapting to standards for comparison purposes and accessing the information needed to determine if ESG factors are maximizing value.

Inseparable Impacts

Corporate environmental responsibility reporting was the earliest focus of non-financial disclosure. It began as voluntary reporting as a means of conveying a brand image that is concerned with more than strict regulatory compliance. Prompting some of the reporting was the emergence of the concept of corporate responsibility coupled with a plethora of court cases arising out of events like catastrophic oil spills, destruction of natural resources (i.e. deforestation), and environmental damage causing hardships in communities. People began holding businesses accountable for their practices, wanting to know what they were doing to prevent these catastrophes and to help the people harmed by the actions. Investors, of course, were looking at risks to long-term viability.

The Corporate Social and Responsibility (CSR) concept reflects the fact that environmental sustainability issues - like efficient use of resources, disposal of hazardous waste, protection of biodiversity, use of green products, pollution, sourcing of materials - are intricately mixed with social issues - human rights, health and safety of communities, corruption, employment. Governance issues include factors like the composition of the governance structure, executive compensation, and effectiveness of communication with all stakeholders. The three components of ESG are inseparable, leading to sustainability reporting rather than environmental reporting only. The sustainability reporting trend in the increasing use of non-financial disclosure is also attributed to legislation requiring disclosure of certain items, like the conflict minerals disclosure requirements of the *Dodd-Frank Wall Street Reform and Consumer Protection Act.* More stock exchanges around the world are also recommending listed companies report on ESG aspects.

Moving Towards Standardization

Over the years, companies have establishment performance measures, but businesses reported what they wanted and in the form they wanted. Lack of standardized methods for measuring and reporting the data, and separation of the reporting for financial and non-financial information, has made it difficult to interpret the information presented and to compare companies. Sustainability reporting provides the information stakeholders want, but it also improves decision-making by identifying risks and opportunities, strengthening a positive brand reputation and producing increased market share. The evolution of non-financial disclosure has moved along a spectrum of environmental sustainability reported to mollify business critics to ESG reporting as a critical management process as important as financial reporting.

The one major difference between financial reporting and non-financial disclosure is there are standards in place for financial reporting, like the International Financial Reporting Standards and Generally Accepted Accounting Principles. One of the biggest challenges companies face in non-financial disclosure is determining the data to collect, the information to report, and how to report it. Organizations should identify what is material to their success. For example, Coca-Cola will report on water stewardship, while Ford Motor Company will include investments in electrified vehicles. There is growing interest in establishing standards, and organizations have been developing and improving sustainability reporting for many years.

The Sustainability Accounting Standards Board (SASB) is one such organization. The independent nonprofit develops accounting standards for various industries through evidence-based research and consultation with a variety of stakeholders. Implementing standards requires reliable data. SASB interviewed Sara Neff, Senior Vice President of Sustainability at Kilroy Realty Corporation, about the challenges of implementing SASB standards for the first time in its 10-K filing with the SEC.[1] The first issue was the lack of externally assured sustainability data. The second issue was the fact service providers (third party sustainability data verification and external counsel providers) were unfamiliar with SASB guidance terms. The company decided to have a legal team clarify the terms and to use year-old externally assured data that was collected by the accounting team and external auditors. The end result is that financial reporting and the sustainability reporting have different reporting years.

Identifying Relationship of Operations and ESG Impacts

Integrated reporting is the newest trend in non-financial disclosure. It is more than just publishing a single report. Integrated reporting considers the relationships between operations and ESG impacts. The International Integrated Reporting Council helps organizations communicate a "...clear, concise, integrated story that explains how all of their resources are creating value."[2] Quantitative and qualitative data measures the transformation of six capital inputs into outputs through the functioning of the business model. The inputs are financial, manufactured, intellectual, human, social and relationship, and natural. The goal is to better understand the impact of inputs by translating ESG data into financial data so they are more understandable. Each company determines the relative capital inputs.

The Global Reporting Initiative (GRI) developed the first global standards for sustainability reporting, and thousands of companies around the world are voluntarily participating.[3] Also developing standards are Account Ability and Principles for Responsible Investment. The fact there is a number of organizations developing and promoting non-financial reporting agencies is good from the perspective that it accelerates momentum for the adoption of non-financial disclosure. It also creates another challenge: Which set of standards should a corporation adopt? In the U.S., SASB has emerged as the leader, but global organizations should consider GRI reporting methodologies. Whatever standards are selected, the company needs to manage the non-financial disclosure so that it is defensible, transparent, connected to the company's values and goals, and coordinated with the supply chain. The information needs to have real-world meaning to the business and its stakeholders.