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# The corporate response to sustainability reporting

A 2006 survey found that overall reporting on sustainability and governance issues by listed South African companies has improved, but environmental management needs more attention.

by Jens Unterlerchner and Daniel Malan

**B**usiness ethics and corporate governance are becoming increasingly important topics in the business world. Corporate governance has gained strategic significance because poor governance can cost companies dearly, both in reputation and financial damage. These global trends have also had an impact on the way in which companies report on their activities.

*Sustainability reporting* is a philosophy that expects companies to broaden their accountability beyond simply reporting on financial performance to shareholders. Also referred to as *triple bottom line reporting*, it implies that businesses should publicly disclose information about their economic, environmental and social performance. There is an increasing awareness in society that financial reporting alone no longer satisfies the needs of shareholders, customers,

communities, and other stakeholders for information about the overall performance, or impact, of the company.

According to a 2004 KPMG survey of Integrated Sustainability Reporting in South Africa, several companies at the time indicated that the monitoring and disclosure of sustainability issues had proved to be beneficial, especially in matters such as improving systems to reduce waste disposal, to prevent lost time in incidents, or to cut remediation costs due to spills. Others argued that improved social performance in the communities in which they operate – achieved through community goodwill and the promotion of worker-company partnerships – increased the security of their installations and sites.

Research done at the University of Stellenbosch Business School (USB) set out to determine the extent of social and environ-

mental auditing and reporting in financial year-end reports by South African companies listed on the JSE Securities Exchange (JSE). This research, which examined reporting for the 2006 financial year, was done in cooperation with KPMG and as a follow-up of the 2004 KPMG survey.

The 2006 survey established that:

- overall reporting on sustainability and governance issues has improved from 2004;
- companies are publishing additional detail on the implementation of black economic empowerment (BEE) and transformation policies; and
- corporate governance and ethical compliance have increasingly been entrenched in companies' corporate culture.

What is worrying, however, is that companies have not started to address environmental management in a substantial way. In the

light of climate change concerns and South Africa's fragile bio-resource base, this dimension of companies' activities certainly needs more action.

## Sustainability reporting in South Africa

Three important trends impact on the onus on South African companies to adhere to the principles of sustainability reporting. These are the King II Report, the international Global Reporting Initiative (GRI), and the JSE's Socially Responsible Investment (SRI) Index.

**The King II Report.** In 1994, corporate governance in South Africa was institutionalised by the publication of the King Report on Corporate Governance that was set up to ensure transparency and accountability within companies. The revised King II Report was released in 2002 and, in 2003, compliance

**The GRI framework.** The GRI develops and disseminates globally applicable sustainability reporting guidelines which provide a framework for reporting on an organisation's economic, environmental and social performance. The first draft guidelines of the GRI were released in 1999 and updated in 2002. The third generation (G3) of the reporting guidelines was released in October 2006.

The GRI is an independent institution that involves a multi-stakeholder process. Its guidelines, which are for voluntary use by organisations, are not a code of conduct or a performance standard, but merely provide principles to guide the preparation of an organisation's sustainability report. The guidelines assist organisations to present a balanced picture of their economic, environmental and social performance. They further facilitate benchmarking and the comparability of published information on sustainability

of impacts and issues, thereby addressing the organisation's impact on the economic condition of its stakeholders and on economic systems.

- There is a consolidation of environmental indicators, with more focus placed on biodiversity and water indicators.

According to the GRI framework, there are certain standard disclosures that should be included in sustainability reports. Standard disclosures can be split into three categories:

- **Strategy and profile:** disclosures that set the overall context for understanding organisational performance, such as the organisation's strategy, profile and governance.
- **Management approach:** disclosures that cover how an organisation should address a given set of topics in order to contextualise the interpretation of performance in specific areas.
- **Performance indicators:** indicators that explain the economic, environmental and social performance of the organisation.

## The reason for the recent changes in corporate governance worldwide is to promote greater corporate accountability, transparency and stakeholder confidence in companies

with certain aspects of this report was made a compulsory requirement for companies listed on the JSE. These requirements adopt a *comply or explain* approach, which means that companies have to report on whether they comply with the recommendations of the King II Report, or explain the reasons for their non-compliance.

The King II Report contains a full chapter on Integrated Sustainability Reporting, including the requirement that every company should report at least annually on the nature and extent of its social, transformation, ethical, safety, health and environmental management policies and practices. Also, with King II, the importance of risk management received official consideration for the first time in South Africa. The report recommends that companies audit their risk exposure annually and disclose this information to their shareholders. In order to conform to international best business practices, it is of paramount importance that organisations implement sound corporate governance structures. The reason for the recent changes in corporate governance worldwide is to promote greater corporate accountability, transparency and stakeholder confidence in companies.

issues. The guidelines are designed for use by organisations of any size, sector or location.

The G3 guidelines on sustainability reporting include major improvements in comparison to the previous model. Some of these changes are:

- There is a wider focus on company strategy and analysis, providing a more concise overview of a company's strategic approach to sustainability management. This information could be of specific value to investors.
- Economic indicators cover a wider range

**The SRI Index.** The SRI Index was launched by the JSE in 2004 as a means of identifying companies that have integrated the triple bottom line approach into their business activities. The aim is to facilitate investment in such companies.

For each of the triple bottom line categories, namely environmental sustainability, economic sustainability and social sustainability, the SRI Index is structured to reflect the complex nature of social responsibility in South Africa. This is spelled out in the detailed criteria for acceptance to the SRI Index (**see box**). The principles of good corporate governance – fairness, accountability, responsibility and transparency – are common to all three reporting categories. A company must address each of these three categories to be recognised as having integrated sustainability into its business practices.

### Criteria for acceptance to the JSE's Socially Responsible Investment (SRI) Index

- **Environmental sustainability reporting** should reflect strategies to measure and monitor the impact a company has on the utilisation of a country's natural resources, and to ensure that resources are used in a sustainable manner, while negative impacts on the environment are reduced.
- **Economic sustainability reporting** addresses whether a company focuses on short-term profits or has positioned itself in order to achieve long-term growth.
- **Social sustainability reporting** should give recognition to the fact that a company is a key component of modern society, and that a company needs to maintain positive relationships with a wider range of stakeholders. In South Africa companies need to show that they are engaged in social upliftment, as well as in redressing imbalances caused by past political systems.

Listed companies are invited annually to submit details voluntarily to be assessed against the SRI Index Criteria. The JSE SRI Index has become an important motivator for companies to include more detailed information on sustainability issues. At the time of this survey, there were 58 companies listed on the JSE SRI Index.

### Investigating company reports

The USB research project targeted all companies that are listed on the JSE and, as a subsection, also companies listed on the JSE SRI Index. The main aim was to gain some insight into the importance given to corporate governance and sustainability reporting by South African companies.

The survey included all companies that were listed on 29 May 2006 on both the

All Share Index and the SRI Index of the JSE. Annual reports published in the 12 months prior to June 2006 formed the basis of the investigation. A total of 141 company reports fell into the specified time span. In the case of the SRI Index, 57 of the 58 companies listed were analysed, as their annual reports were published within this time span.

The questionnaire applied in this survey was the same one that had been developed by KPMG Sustainability Services and used in their published *Survey of Integrated Sustainability Reporting in South Africa* in 2004. The data of the 2006 survey could therefore be compared with those of the 2004 survey. Further questions were added to the 2006 survey in order to identify trends in three specific areas, namely climate change, biodiversity and compliance, with applicable sector charters.

### Trends in sustainability reporting revealed by the study

**Comparison with 2004.** The first part of the analysis focused on a comparison between the 2006 findings in respect of sustainability reporting and those of the earlier 2004 survey.

The **table below** shows the different categories of compliance or reporting, and the percentage of companies that reported on each category in the respective years.

In interpreting the figures given, one should note that company data were divided into three levels of compliance, namely *fully addressed*, *partially addressed*, and *not addressed at all*.

In the table below, compliance was regarded as fully or partially addressed.

Partial or full compliance with reporting categories: Comparison between 2004 and 2006				
Category	2004	2006	0% ←	→100%
Compliance with King II report	99%	96%		
GRI guidelines referenced	15%	35%		
BEE: transformation	77%	82%		
BEE: preferential procurement	38%	73%		
Human capital development	63%	79%		
Corporate social investment	72%	88%		
Health and safety policies	60%	77%		
HIV/Aids reporting	65%	73%		
Reference to code of ethics	75%	81%		
Safe systems *	32%	49%		
Statement of ethical standards met	10%	89%		

\*Safe systems refer to protected systems available for reporting possible fraud or ethical misconduct.

The most frequently discussed topics can be grouped into three distinct areas of focus:

**Black economic empowerment (BEE) and transformation.** The topic that was most comprehensively reported on was the issue of BEE and transformation in South Africa. This is shown by high scores in the categories BEE transformation (82%), preferential procurement (73%) and corporate social investment (88%). These categories often included financial information on these policies.

**Corporate governance and compliance with ethical standards.** This is reflected in high scores on compliance with King II (96%) and the existence of codes of ethics (81%).

**HIV/Aids, and health and safety.** Of the companies surveyed, 73% disclosed information regarding their HIV/Aids policies, with many of them publishing detailed information on prevalence testing and other

measures implemented. Health and safety policies in place at the workplace were reported on by 77% of the companies.

**Comparison with SRI Index companies**

The second part of the analysis compared the degree of sustainability reporting between companies included in the SRI index and all companies, using the 2006 data. The SRI Index did not yet exist when the 2004 survey was conducted. In this analysis, the sector charter category is also new to the 2006 survey. The results are depicted in the **table below**.

This analysis shows that there is a notable difference in conformance to all the categories examined between the two groupings. This was to be expected, given the strict guidelines for admission to the SRI Index, and it perhaps reflects the rigour of the practical admission process.

**New categories surveyed**

Three categories that had not been included in the 2004 survey were added in the 2006

study. They are sector charters, climate change and biodiversity.

**Sector charters.** At present only the mining charter has been gazetted officially by government, with industry-specific charters currently being developed in the petroleum, maritime, tourism and financial services sectors. A charter typically provides a basis for consulting with other stakeholders, including the government. The financial services sector charter, for example, involves a partnership programme as outlined in the government’s strategy for broad-based black economic empowerment (BBBEE) and sets targets in respect of aspects such as human resource development, procurement policies, access to financial services and ownership.

The comparison of sector charter reporting between all companies (48%) and SRI Index companies (69%) is shown in the **table below**. Of the companies that comply in this respect, the charters most often mentioned are the Mining Sector Charter (30%), the

Partial or full compliance with reporting categories: Comparison between All and SRI				
Category	ALL	SRI	0% ←	→ 100%
Compliance with King II report	48%	69%		
GRI guidelines referenced	35%	81%		
BEE: transformation	82%	96%		
BEE: preferential procurement	73%	93%		
Human capital development	79%	97%		
Corporate social investment	88%	100%		
Health and safety policies	77%	95%		
HIV/Aids reporting	73%	93%		
Reference to code of ethics	81%	88%		
Safe systems	49%	77%		

Financial Services Charter (25%), the Maritime Sector Charter (12%) and the Information Technology and Communications (ITC) Sector Charter (10%).

**Climate change.** One of the most serious environmental concerns that receives attention worldwide is the impact of climate change on the natural environment. Central to the issue is the emission of carbon dioxide into the atmosphere and the subsequent development of international emissions trading and carbon markets. This has resulted in emissions trading becoming a commonly reported business opportunity. Several companies in the survey reported a target to reduce their greenhouse emissions and/or energy use, as well as the usage of water in the production process. But, overall, progress in this regard may be too slow.

The **graph below** shows the extent of reporting on the categories of climate change and biodiversity. Companies classified in the resources sector were most prominent in including information on climate change and carbon emissions in their published annual report (71%), followed by 33% of companies in the ITC sector, 24% of retail sector companies and 22% of the food and beverages companies. In all other sectors, less than 20% of companies addressed this matter. In the transport sector not even one company thought it worthwhile to mention it in its annual report.

**Biodiversity.** South Africa has a rich biodiversity and contains about 10% of the world's plants and 7% of its bird, reptile and mammal species. With its rapidly growing population,

South Africa needs more resources to survive. This will inevitably cause the country's resource base to shrink more and more, putting pressure on the environment. Therefore, the onus is on companies also to adhere to international environmental standards in order to protect this resource base.

As is evident with regard to climate change, companies are still reluctant to address biodiversity in their annual reports. Again it is the resources sector that leads the way with 67%, followed by the food and beverages and ITC sectors with 33% each, and the industrials with 22%.

of the G3 framework has allowed for a more systematic approach to reporting according to the GRI, and companies will increasingly use this scorecard to determine their own performance.

The continuing debate on global warming and climate change is starting to affect companies that are operating in resources sectors. Yet the topics that were less frequently addressed involved environmental issues, showing that the focus on environmental management is still small and that companies have not really shifted their attention to reporting on environmental

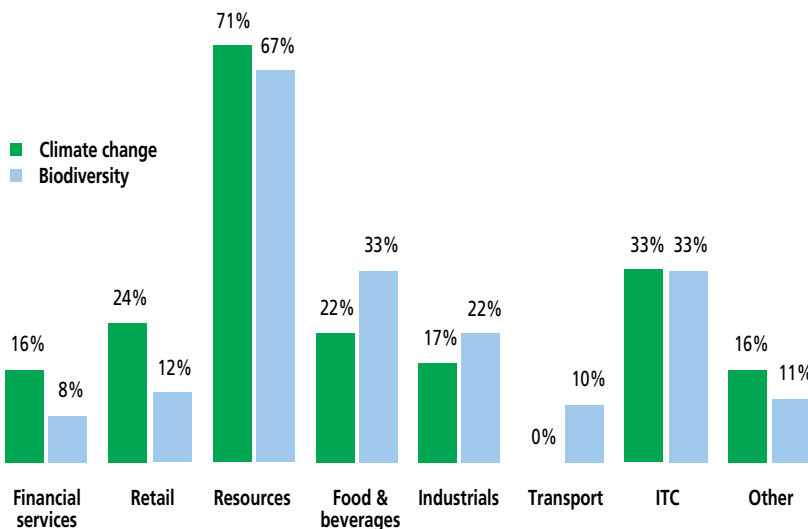
## ... reporting on climate change, resource management and biodiversity will feature more prominently in future annual reports

### Future trends in sustainability reporting

The results of this survey have shown that the companies listed on the JSE All Share Index are continually improving the quality of their reporting in terms of sustainability issues. Adherence to the requirements of the King II Report, as well as the increased application of the Global Reporting Initiative (GRI) framework, was well documented in the survey. The application of the GRI framework gives the company the ability to compare data and thus gain valuable information on internal performance and comparisons with sector benchmarks. The subsequent development

matters. The current worldwide debate on global warming and climate change, as well as the ratification of the Kyoto Protocol in February 2005, is expected increasingly to put pressure on companies to report on their environmental management policies and activities. It is likely that reporting on climate change, resource management (water and electricity) and biodiversity will feature more prominently in future annual reports.

At present there is a trend to publish comprehensive stand-alone sustainability reports and provide only a summary in the annual reports. It is expected that this trend will continue in future reporting. Few of the sustainability reports were subjected to independent auditing and assurance processes. International trends, however, suggest that there will be an increase in external assurance of the published sustainability reports. Stakeholders want to be sure that the information published by a company is a true reflection of its sustainability policies, and not simply a public relations brochure.



Extent of reporting on climate change and biodiversity



Jens Unterlerchner (jens@denu.com.na) conducted this research as his MBA study project at the USB under the supervision of Daniel Malan. The study, *2006 Survey of Integrated Sustainability Reporting in South Africa: An investigative study of the companies listed on the JSE Securities Exchange All Share Index*, was presented in December 2007.