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EY Building a better working world

Does the increase in supportive reporting frameworks help or hinder corporate transparency?

Abstract for EMAN Congress, March 2014

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1. TRANSPARENCY AT FIRST IN FINANCIAL REPORTING

2. A NEW TRANSPARENCY: the story behind the company

- Overview of the Dutch transparency landscape
- Maturity lifecycle of sustainability reporting
- Reporting modalities

3. MATERIALITY: bringing transparency and relevance together

- How companies cope with differences in guidance
- Do different interpretations of materiality lead to the same transparency?
- Conclusion: many roads to Rome

1. TRANSPARENCY AT FIRST IN FINANCIAL REPORTING

There have been many changes in corporate financial reporting in the past ten years. Companies no longer have the discretion to decide what information they disclose in their reports. In the Netherlands, one of the change agents was the launch of the Code Tabaksblat in 2003. It is a code of conduct to improve the transparency of listed companies' annual statements, improve the accountability of supervisory boards and strengthen shareholder protection. Corporate behaviour has been subject to very critical scrutiny and the pressure on corporate reputations was reflected in share prices. Share price = book value + plus other forms of capital like reputational and intellectual capital).

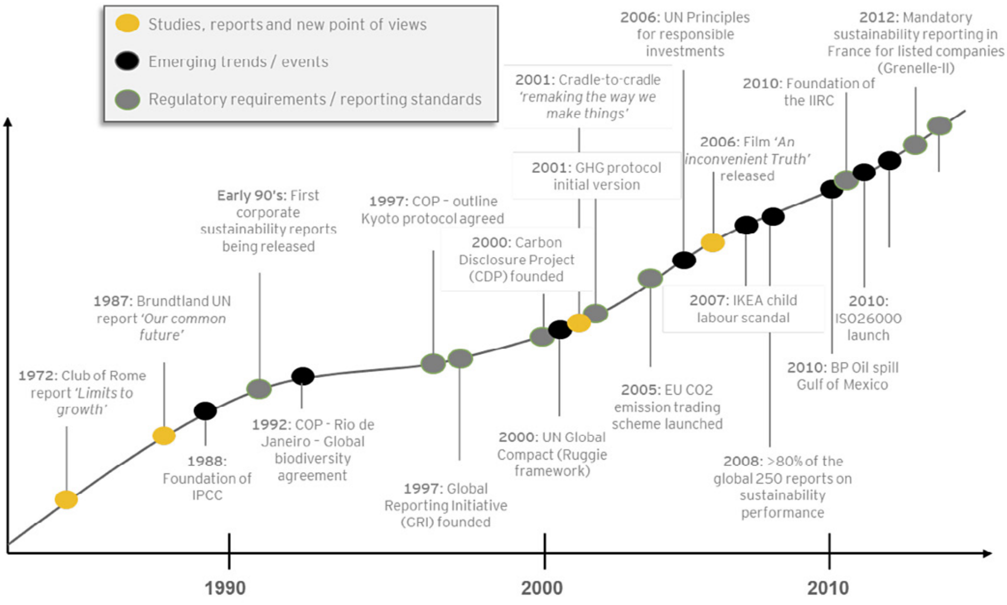
As a matter of policy, companies must provide more transparent information. The stricter governance that followed the Enron, Worldcom and other accounting scandals placed responsibility firmly on the shoulders of executive directors, supervisory directors, shareholders and auditors. Supervisors and regulators also raised the need to publish better annual reports. Since 2003, the Netherlands Authority for the Financial Markets (AFM) has subjected the reports of companies listed in the Netherlands to annual checks and thematic investigations. Introduction of the IFRS in 2005 restricted corporate discretion even further. Reports become more complete, but less accessible. The average length of the annual reports issued by companies on the Amsterdam stock exchange (AEX) increased year on year and doubled over the last ten years to an average of more than 213 pages. The reports were more complete but their length and complexity were a deterrent to readers, even specialists.

Corporate social responsibility reports have also taken off in recent years as the authorities, investors and civil society organisations have demanded greater transparency on the social and environmental consequences of business conduct. The fact that companies are facing increased pressure to collect information that was previously thought to be of little if any relevance has helped shape the development of corporate social responsibility.

Companies have been disclosing an increasing amount of information to satisfy the demands of stakeholders. Specifically, they have offered complementary information to providers of financial capital who increasingly view the snapshot reflected by financial statements and sustainability reports as inadequate. Research performed by ACCA (Association of Chartered Certified Accountants) concluded that investors:

- Are missing a link between current reporting disclosures and business strategy and risk and do not believe that sufficient information is provided to assess financial health.
- Current non-financial reporting is not sufficiently relevant and non-financial information should be better integrated with financial information.
- Qualitative policy statements are important to assess financial materiality, but quantitative key performance indicators (KPIs) are essential.
- Accountability mechanisms should be part of non-financial reporting, either through new board oversight mechanisms, third party assurance, and/or shareholder approval at annual general meetings.

FIGURE 1: Sustainability (reporting) developments in the past decades



2. A NEW TRANSPARENCY: The story behind the company

Today, stakeholders want to know what companies do and learn "the real story" behind their operations. Stakeholders want more information on how a company's strategy relates to both its financial and non-financial performance. They want to understand the full picture of added value, how financial value creation is linked to non-financial value creation or destruction.

This call for greater transparency is backed up by national and international frameworks and regulations and companies are responding to the changing demands. A wide variety of reporting frameworks and initiatives is now available and their number is still growing, as evidenced by the recent launch of the US SASB initiative (Sustainability Accounting Standards Board).

Ernst Ligteringen, Chief Executive of the Global Reporting Initiative (GRI), stated in his keynote speech at the GRI conference in May 2013 that international and national institutions were continuing to develop existing and new frameworks to support companies in their transparency efforts. GRI has identified 180 sustainability reporting initiatives in 45 countries and regions.

Participants at the GRI conference said they expect an increase in transparency regulations, as shown in the graphs below[1].

FIGURE 2: Expected timeframe sustainability reporting

Would you expect sustainability reporting to become regulated in your country?

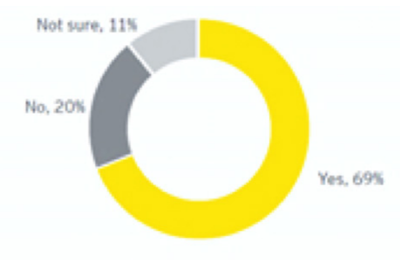
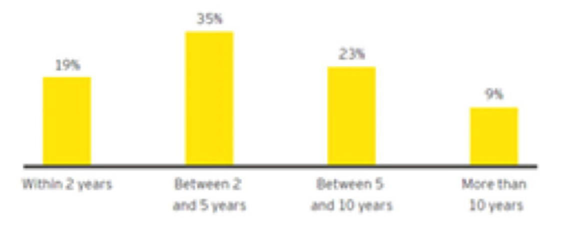


FIGURE 3: Expected country regulation regarding sustainability reporting

If you expect sustainability reporting to be regulated in your country, what is the expected time frame?



1. Sustainability Reporting, the time is now, EY and GRI, January 2014

AN OVERVIEW OF THE DUTCH TRANSPARENCY LANDSCAPE

The main reporting entities/frameworks defining the landscape for Dutch companies are:

- the international GRI framework
- the International Integrated Reporting Council (IIRC)
- the Dutch Transparency Benchmark
- the forthcoming EU Directive on disclosure of non-financial information.

Sustainability

The Global Reporting Initiative was one of the first to enhance sustainability reporting. It was launched in 1997 to make sustainability reporting standard practice by providing for a reporting system that enables all companies and organisations to measure, understand and communicate sustainability information. GRI is an international not-for-profit organisation, with a network-based structure. The Framework is developed collaboratively with expert input from professionals and organisations from all over the world. GRI recently launched its G4 version.

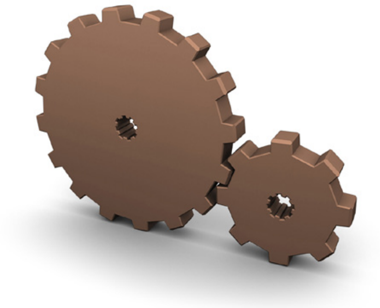
Value creation

The International Integrated Reporting Council
launched its first version of a framework for integrated reporting last December 2013. "Integrated Reporting combines the most material elements of information currently reported in separate reporting strands (financial, management commentary, governance and remuneration, and sustainability) in a coherent whole (…)".

An integrated report is a concise communication about how an organization's strategy, governance, performance, and prospects lead to the creation of value over the short, medium and long term. The pillars of an integrated report are the company's capitals (financial, manufacture, intellectual, human, social and relationship capital and natural) and its process of value creation on the capitals as described in the business model.

FINANCIAL

The pool of funds available to an organization for use in production of goods or the provision of services.



MANUFACTURED

Manufactures physical objects for use in the production of goods and service.

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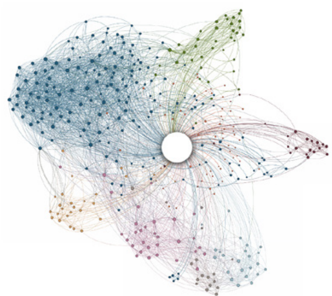
INTELLECTUAL

Organizational, knowledge-based intangibles.

HUMAN

People competencies, capabilities and experience and their motivations to innovate.



SOCIAL AND RELATIONSHIP

TThe institutions and relationships established within and between each community, group of stakeholders and other networks, and the ability to share information, to enhance individual and collective well being

NATURAL

All renewable and non-renewable environmental stocks that provide goods or services that support the past, current or future prosperity of an organization.

Traditional financial reporting does not provide an insight into how a company creates value. This is illustrated by the gap between the company's market value and its book value. Traditional reporting was not intended to provide an insight into value creation because it is based principally on a historical understanding of value and reporting conventions such as prudence and matching. Stakeholders, by contrast, seek a more economic, forward-looking understanding of value creation.

The purpose of integrated reporting is to produce concise and clear reports. More information does not necessarily lead to more effective communication. By telling a more coherent, short and powerful story, a company can better explain the context in which it operates and how it responds to demands from the market.
The aim of the IIRC also is to increase connectivity of information as well within the integrated report as to information outside the report and to facilitate comparisons between reports.

- Links to websites: An integrated report may be hyperlinked (or referenced, if the integrated report is paper-based) to information on the organization's website or on other websites.

- Social media i.e., interactive platforms that enable sharing of user-generated content
  Information provision: the capacity to connect information from different sources using social media monitoring tools that allow users to search, track and analyze information about organizations or topics of interest.
  Interaction: Social media as elements in an organization's information and communication policy:
  - as a means to engage with stakeholders
  - to disseminate information generated by the IR process

- XBRL
  Comparability of information: Consistent semantic definitions of and explicit relationships between components of an integrated report; XBRL can capture the integrated reports of various organizations in a machine-readable format so that intended users can compare them more easily.

Relation between GRI and IIRC
The sustainability reporting process defined by the GRI Sustainability Reporting Framework can help companies that want to produce integrated reports in three main ways:

1. Identifying material topics – topics that express the core link between business goals and sustainability impacts

2. Stakeholder engagement – dialogue to help determine material impacts and manage risks and opportunities

3. Performance indicators – measuring, managing and reporting material issues using an internationally accepted framework

The frameworks below are derived principally from the foundations laid by the GRI And IIRC.

The Dutch Transparency Benchmark
The Transparency Benchmark is an annual study of the content and quality of the corporate social responsibility reports of Dutch organisations. It was introduced by the Minister of Economic Affairs in 2004 with the expectation that organisations themselves would improve their social and environmental performance if they were held to account for their performance in these areas. Every year the Transparency Benchmark awards the Crystal Prize to the most transparent organisation. The Crystal Prize is a leading Dutch award for social and environmental reporting.

Participants acquire knowledge of the generally accepted criteria for corporate social esponsibility reporting, obtain an insight into potential improvements and have an opportunity to compare themselves against other companies inside and outside their own industry.

The EU Directive on disclosure of non-financial information
26 February 2014 the European Parliament and Council have reached agreement on the Commission's proposal. Large public-interest entities (mainly listed companies and financial institutions) with more than 500 employees will be required to disclose relevant and useful environmental and social information in their management reports. The scope includes approx. 6 000 large companies and groups across the EU. The companies will have to disclose information on policy choices, risks and results in relation to the environment, social and employee-related matters, respect for human rights, anti-corruption and bribery, and diversity in the executive board. Companies will be required to disclose concise, useful information necessary for an understanding of their development, performance, position and impact of their activity, rather than a fully-fledged and detailed report. Furthermore, disclosures may be provided at group level, rather than by each individual affiliate within a group.
The draft Directive has been designed with a non-prescriptive mind-set, and leaves significant flexibility for companies to disclose relevant information in the way that they consider most useful, or in a separate report. Companies may use international, European or national guidelines which they consider appropriate (for instance, the UN Global Compact, ISO 26000, or the German Sustainability Code). At the end 2016 the directive should be implemented in national law.

MATURITY LIFECYCLE OF SUSTAINABILITY REPORTING

A growing number of companies worldwide are publishing sustainability reports and a large number of them are based on the GRI guidelines, which increases not only transparency but also comparability. According to the GRI, from 2006 to 2010, the number of companies using the guidelines increased year-on-year from 22% to 58%. In 2012, 53% of S&P 500 companies published a sustainability report, with 63% of them adhering to GRI reporting standards. Ernst Ligteringen (Chief Executive, GRI) announced at the GRI conference in May 2013 that 95% of the largest companies in the world were already producing a sustainability report.[2]

In line with global trends, sustainability reporting is becoming more professional in the Netherlands, too. Almost all listed companies report on sustainability in accordance with GRI guidelines. In general, the number of GRI reports in the Netherlands is increasing. The number of GRI reports submitted to the GRI database rose from 28 in 2006 to 98 in 2012 but fell to 75 in 2013.

TABLE 1: Number of dutch GRI reports (submitted to the GRI database)
Source: EY analysis based on GRI Sustainability Disclosure Database (2014)

Year	Number of GRI reports (submitted to the GRI database)
2006	28
2007	32
2008	42
2009	52
2010	69
2011	91
2012	98
2013	75

2012 AEX
25 listed companies
23 reports at a GRI level
16 reports submitted to GRI database

2012 Top 150 Transparency Benchmark
70 reports with external assurance
80 reports without external assurance

2. Sustainability Reporting, A Glass Lewis Issue Report (2013)

Specifically in respect of the AEX listed companies[3] we find that in 2012, 25 companies were AEX listed. Of those 25 companies, 92% reported to a GRI level (only two listed companies did not report in accordance with GRI). Only 64% of these sustainability reports (in total 16 out of 25) were submitted to the GRI database.

Increased assurance

Sustainability reporting is becoming more mature. Companies are showing greater consistency and continuity. They are using more actual figures (absolute numbers and percentages) instead of just claiming they had improved their performance compared to the previous year. A growing number of companies also have their sustainability reports provided with assurance by an auditor. In 2013 70 of the 150 companies in the top of the Dutch Transparency Benchmark had their sustainability reports (partly) audited. 80 companies did not.

REPORTING MODALITIES

The majority of companies in the Netherlands still publishes two separate reports, an annual report and a sustainability report. The modality of publishing a combined annual and sustainability report is rapidly gaining ground, although financial and non-financial information is not necessarily interlinked or related to value creation.

The tables below show that in 2013 50% of the top 150 organisations in the Transparency Benchmark published two separate reports and already 45% published an integrated report. The latter either being a CSR chapter in the annual report, or being a report containing integrated information on financial and non-financial information. And we see that for the industry highly represented in the top 150 of the Transparency Benchmark, professional services, an integrated report is the most popular modality. In the next four strongly represented industries the dominant modality is still two separate reports.

TABLE 2: Reporting modalities top 150 Transparancy Benchmark

Source: EY analysis based on data of the Transparency Benchmark 2013 and desk research

2013 (reports on 2012)	Number of companies	% of companies
No report	7	5%
Separate CSR report	76	50%
Integrated report	67	45%
Total	150	100%

3. EY analysis based on GRI Sustainability Disclosure Database (2014)

TABLE 3: Reporting modalities at industry sector level
Source: EY analysis based on data of the Transparency Benchmark 2013 and desk research

	# companies in sector	No report	Separate CSR report	Integrated report
Services	29		45%	55%
Banks and insurers	19		63%	37%
Food and beverages	15		73%	27%
Construction and maritime	12	9%	58%	33%
Transport	12	8%	50%	42%
Energy	11		36%	64%
Industrial goods	10	20%	30%	50%
Retail	10	10%	50%	40%
Universities	8	25%		75%
Media	6		83%	17%
Technology	6		83%	17%
Consumer products	4		25%	75%
Trading companies	3		67%	33%
Property	3		33%	67%
Other	2		50%	50%
Total	150			

3. MATERIALITY: Bringing transparency and relevance together

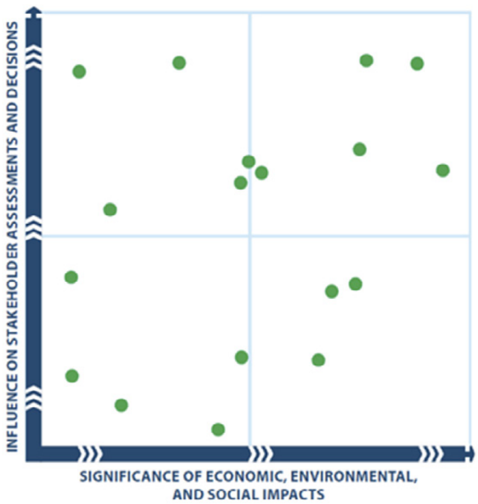
Financial and non-financial reports have become more voluminous in recent years. But more information does not necessarily lead to more effective communication. The concept of materiality has therefore become a central issue in recent developments in reporting frameworks. Surprisingly all the frameworks define the concept of materiality differently.

The international GRI and IIRC frameworks use the concept to identify the topics or matters on which a company should develop policies and disclosure. The Transparency Benchmark also includes materiality in its criteria. The EU Directive mentions the concept of materiality but does not define it.

The Global Reporting Initiative, GRI G4, defines materiality as follows: "Material topics for a reporting organization should include those that have a direct or indirect impact on an organization's ability to create, preserve or erode economic, environmental and social value for itself, its stakeholders and society at large."

The GRI G4 Reporting Principles and Manual state that a Sustainability Report should cover aspects that *"reflect the organisation's significant economic, environmental and social impacts or substantively influence the assessments and decisions of stakeholders'*. It further explains that organisations are faced with a wide range of topics on which they could report. Relevant topics are those that may reasonably be considered important to reflect the organisation's economic, environmental and social impacts, or influence the decisions of stakeholders, and, therefore, potentially merit inclusion in the report. Materiality is the threshold at which aspects become sufficiently important that they should be reported. In defining material aspects, the organisation takes into account sustainability impacts, risks and opportunities as identified by experts, peers and/or stakeholders. The organisation also takes into account the relevant regulatory environment and its own values, strategies and policies. GRI also includes a visual representation of aspects that are widely used by organisations to identify their material issues.

FIGURE 5: Visual representation of prioritization of materiality aspects
Source: GRI Implementation manual



The International Integrated Reporting Council framework defines materiality as follows: "A matter is material if it is of such relevance and importance that it could substantively influence the assessments of providers of financial capital with regard to the organisation's ability to create value over the short, medium and long term. In determining whether or not a matter is material, senior management and those charged with governance should consider whether the matter substantively affects, or has the potential to substantively affect, the organisation's strategy, its business model, or one or more of the capitals it uses or affects." IIRC defines the process in the following steps that all relate to the organisations ability to create value in the short, medium and long term:

1. **Identifying relevant matters.** Relevant for the organisation's ability for value creation, also taking into account stakeholders' perspectives.
2. **Evaluating importance.** This involves evaluating the magnitude of the matter's effect and its likelihood of occurrence.
3. **Prioritising important matters.** Prioritisation based on magnitude.
4. **Determining information to disclose**. Considering different perspectives, both internal and external, to meet the information needs of providers of financial capital and others.

The IIRC definition and process have a clear focus on value creation: matters are said to be material if they influence the organisation's ability to create value. Step 2 in the process includes risk assessment to determine materiality. On the whole, we can conclude that IIRC is closely aligned with concepts that are already familiar to business. We therefore expect the IIRC materiality methodology to be more readily adopted in the boardroom.

The Dutch Transparency Benchmark renewed its criteria at the end of 2013, and introduced the concept of materiality. There is no explanation of the specific criteria concerning materiality, but the Transparency Benchmark seems to follow the GRI definitions by stating: *"the company needs to provide insight in the relative importance of the identified material subjects for both stakeholders and the company, and provide a specific explanation of material subjects in at least two of the three categories of economic aspects, environmental aspects, social aspects."* Companies can score extra points for presenting a materiality matrix, which also seems to refer to the GRI materiality matrix.

The EU Directive on disclosure of non-financial information states companies need to *"disclose a statement including material information relating to at least environmental, social, and employee-related matters; respect of human rights; anti-corruption and bribery aspects."* It gives no further specifics regarding the definition or process of materiality.

HOW COMPANIES DEAL WITH DIFFERENCES IN GUIDANCE

We have analysed how the top 20 companies in the Transparency Benchmark interpret materiality and came to some interesting conclusions. First, companies interpret the GRI concept of materiality differently.

All the companies agree on the interpretation of *"influence on stakeholders' assessments and decisions"*, but there are different opinions on the interpretation of *"significance of economic, environmental and social impacts"*:

- Some companies look at how economic, environmental and social aspects impact the company;
- Some look at how the company influences the economic, environmental and social aspects.
- Some look at both aspects
- Some companies make their own definition and some simply do not define what they mean.

Second, none of the companies uses the IIRC definition of materiality (yet). Our analysis is necessarily based on 2012 reports, an analysis of the 2013 reports might show a different picture since the first IIRC framework was not presented until December 2013. Before then only a draft version was available.

TABLE 4: Interpretation of materiality top 20 Transparency Benchmark
Source: EY analysis based on data of the Transparency Benchmark 2013 and desk research

GRI - influence of company on issue	GRI - influence of issue on company	GRI - both interpretations	Own interpretation	No definition given	GRI -Materiality matrix visual	Other type of visualisation of materiality
6	5	4	3	2	9	2

SOME DEFINITIONS AS USED BY COMPANIES

NS “Priorities in sustainable business practices are determined on the basis of materiality or relevance: a mix of the importance to stakeholders on the one hand and the actual impact that NS can have on the topic on the other.” (GRI – influence of company on issue)

Achmea *“In the context of this report, a topic is considered to be ‘material’ if it is relevant to both the stakeholders and Achmea. The greater the impact of the topic on society and the business operations, results and strategy of Achmea, the greater its materiality.” (GRI – influence of issue on company)*

Philips *“Based on ongoing trend analysis and stakeholder input, we identify the key material issues for our company from a sustainability perspective. We have mapped the issues in the table below, taking into account the:*

- *level of concern to society at large and stakeholders, versus impact on Philips, and*
- *level of control or influence we can have on an issue through our operations and products/solutions.”*

(GRI – both interpretations)

Van Gansewinkel *“We map out the importance of the various topics by assigning scores for:*

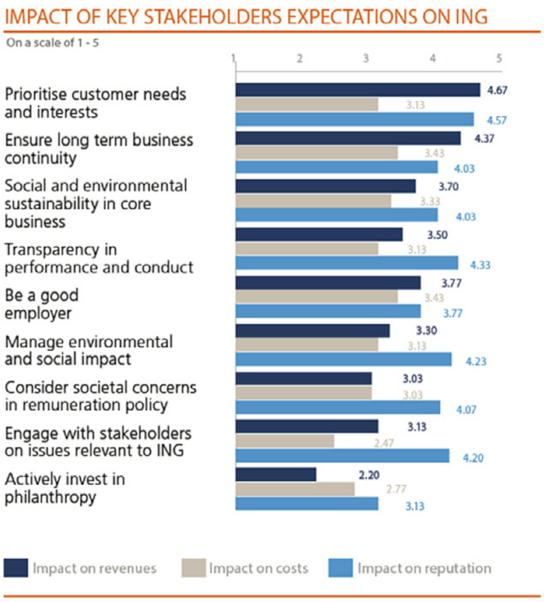
- *The impact on the organisation*
  - The importance of the topic in relation to the core business;
  - The organisation’s contribution to or impact on the public debate about the topic.
- *The importance for the stakeholders*
  - Society’s interest in the topic (high or low level of engagement);
  - The effects for our reputation.”

(Own interpretation by adding public debate and reputation as criteria)

Examples of materiality beyond the GRI definition as used by companies.

ING Example of an extended form of materiality analysis.
"We initiated an internal survey to determine company perceptions regarding the potential impact of each issue included in the analysis. A group of 30 ING specialists representing a broad cross-section of our businesses and different disciplines were asked to assess and score these focus areas for their potential impact on ING's costs, revenue and reputation. As a result, the materiality overview combines both stakeholder expectations and company perceptions and depicts the priority of the identified issues."

FIGURE 6: Extended materiality as presented by ING



BNG Bank

Example of materiality analysis in which stakeholders' interests are explicitly linked to the organisation's overall business strategy.

"To ensure that the bank's strategy and business processes are carefully aligned, BNG Bank has identified a number of topics / focus areas which are critical factors in the relations it enjoys with its stakeholders, from both the stakeholders' perspective (what does the stakeholder want from BNG Bank?) and from the bank's perspective (what does BNG Bank want to achieve?). The ongoing challenge is to serve the interests of BNG Bank's stakeholders and its own interests at the same time. The parties and their interests are set out in the matrix below. The key topics / focuses are shown in italics; these lie at the heart of the themes and key indicators used to describe BNG Bank's CSR policy."

TABLE 5: Fragment of the matrix as presented by BNG Bank

Stakeholder	Stakeholder perspective	BNG perspective
Clients	– *good value for money* – *sustainable products* – *financing of sustainable investments* – solutions to problems – *partnership* – good information provision – integrity	– market share / margin – client appreciation – minimize risk of credit loss – continuity – statutory and regulatory compliance
Investors	– *optimize return / security* – liquidity – *integrity and transparency*	– permanent access to the capital and money markets – optimize funding prices/mix
Rating agencies	– *integrity and transparency*	– maintain high ratings
Shareholders	– *fair return/dividend* – security of the return – continuity – interest of public authorities	– continuity of shareholding – CSR policy – discharge from liability for the management

DO DIFFERENT INTERPRETATIONS OF MATERIALITY LEAD TO THE SAME TRANSPARENCY?

The analysis found that companies interpreted materiality differently and when we take a closer look at the content of the material themes companies have defined we do see differences in scope.

- Some companies follow exactly the GRI aspects in their definition of materiality
- Some companies define specific sector themes and relate their material themes to their business strategy and value creation.

Interesting enough though we see these differences in scope along all the distinguished categories of process of materiality analysis.
For example NS (GRI – influence of company on issue) identified sector specific and business related material themes like 'noise' , 'accessibility' and 'sustainable mobility'. Achmea (GRI – influence of issue on company) also identified sector specific and business related themes like 'stalled housing market', 'cars becoming safer' and 'need for simple transparent products'. Also in the above presented examples of ING and BNG Bank we find examples of sector specific and business related materiality.
It seems to be the case that it is not so much the definition of the process that defines the outcome of the materiality analysis, but rather the definition of the scope.

CONCLUSION: MANY ROADS TO ROME

Concerning the guidance offered to companies for the process of materiality we can conclude that the GRI guidance leads to lots of different interpretations, which might cause confusion with companies that are less experienced in sustainability reporting. At the same time it doesn't seem to distract companies from their intentions to go towards more meaningful transparency.

The concept of materiality is designed to stimulate companies to make transparency more meaningful. Bearing that in mind we can conclude that materiality that takes a broad scope and includes sector specific and business related themes is strongest. It helps stakeholders to get an understanding of the interaction between a company and society. The design of materiality by the IIRC challenges companies to go in that direction and therefore deserves more attention from companies than it gets so far.

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