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Guidance on corporate responsibility indicators in annual reports

The information needs of stakeholders and the selection criteria for core indicators

Note by the UNCTAD secretariat

Executive summary

This document provides essential background information on the work of the International Group of Experts on International Standards of Accounting and Reporting (ISAR) in this area, detailing the users and uses of corporate responsibility reporting and the selection criteria applied in the development of ISAR's guidance on corporate responsibility indicators in annual reports. This paper forms an integral part of ISAR's guidance on this subject.

Since its twentieth session, ISAR has recognized the demand for increased relevance and comparability in corporate responsibility reporting, and also recognized the need for providing voluntary technical guidance on such reporting as part of the information presented in corporate annual reports. It was agreed at the twenty-third session of ISAR that UNCTAD should further refine and finalize ISAR's work in this area with a view to providing a voluntary technical tool for enterprises.

This work was undertaken within the framework of ISAR's mandate on promoting harmonization of best practices on corporate reporting, and in recognition of the call in the São Paulo Consensus for UNCTAD to carry out analytical work with a view to facilitating and enhancing positive corporate contributions to the economic and social development of host developing countries.

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Introduction

1. It was agreed at the twenty-third session of ISAR that “UNCTAD should further refine and finalize the guidance on selected corporate responsibility indicators and their measurement methodology with a view to providing a voluntary technical tool for enterprises” (TD/B/COM.2/ISAR/35). This document presents an overview of an enterprise’s stakeholders and their information needs, and provides useful background on the selection criteria and guiding principles employed by ISAR in the development of corporate responsibility indicators. The material presented in this report is based on material previously presented to the twenty-second session of ISAR in the report TD/B/COM.2/ISAR/29. It forms an integral part of the report “Guidance on corporate responsibility indicators in annual reports” (TD/B/COM.2/ISAR/38), and should be considered in conjunction with that report.

2. Among the guiding principles discussed in this document are three key dimensions which evolved during the deliberations of the group of experts:

- (a) The development dimension;
- (b) The performance orientation; and
- (c) The focus on national reporting.

3. At its twenty-first session, the group noted that UNCTAD XI had provided a broader context in which the issue of corporate responsibility could be addressed. In particular it was agreed that “such information could also reflect corporate contributions to the economic and social development of host countries, as well as the need for capacity building” (TD/B/COM.2/ISAR/26). The development dimension of corporate responsibility reporting was again emphasized at ISAR’s twenty-second session, where it was agreed that this work “should continue to reflect corporate contributions to the economic and social development of host countries” (TD/B/COM.2/ISAR/31). This emphasis on the development dimension of corporate responsibility has also been complemented by an emphasis on performance-oriented indicators. At ISAR’s twenty-third session, the group of experts recognized “the increased interest among corporate responsibility reporters in creating more concise, more useful and more performance-oriented reports” (TD/B/COM.2/ISAR/35). A third key dimension of ISAR’s work on corporate responsibility reporting arose during deliberations at the twenty-second session of ISAR, where it was emphasized that the indicators should focus on national reporting. It was noted that national reports were more useful for stakeholders interested in specific countries; it was also noted that users could, if they chose, aggregate national reports to a regional or global level.

4. While environmental issues are also recognized as an important feature of corporate responsibility, this project does not focus on environmental issues, as ISAR has previously conducted extensive work in this area. In 1989, ISAR took up the topic of corporate environmental accounting. In the following years, several recommendations were published in this area: (a) the 1999 report *Accounting and Financial Reporting for Environmental Costs and Liabilities* (UNCTAD/ITE/EDS/4); (b) the 2000 report *Integrating Environmental and Financial Performance at the Enterprise Level* (UNCTAD/ITE/TED/1); and (c) the 2004 manual *Eco-Efficiency Indicators* (UNCTAD/ITE/IPC/2003/7). The five eco-efficiency indicators identified in the 2004 manual are listed in the annex.

I. Stakeholders and their information needs

5. The concept of corporate responsibility draws upon the strategic management theory that says managers can add value to an enterprise by taking into account the social and economic effects of an enterprise's operations when making decisions.¹ This theory claims that managers can best promote the long-term viability of an enterprise by balancing the needs of its stakeholders with the financial requirements of sustaining and growing a business. Reporting on an enterprise's performance in this area is therefore a means to provide shareholders and other stakeholders (as well as managers themselves) an account of an enterprise's impact on society. This added transparency can lead to greater accountability of the enterprise to its principal stakeholders.

6. Enterprises should demonstrate how and to what extent they fulfill their responsibilities toward their stakeholders. These responsibilities are often, though not exhaustively, described and defined in existing regulations, codes, laws and international agreements. As organs of society, enterprises are increasingly being called upon to demonstrate support for both international law as well as internationally-agreed normative statements; this is most clearly reflected in the United Nations Global Compact. Failure to meet society's expectations in these areas may undermine an enterprise's license to operate or public acceptability.

7. Stakeholders are understood as groups of persons that are affected by and/or can influence an enterprise, without necessarily holding an equity share of the enterprise. Their actions can affect an enterprise's brand and reputation, its financial performance, and even its license to operate.

8. Communicating with stakeholders and ascertaining their views, therefore, is very important for enabling enterprises to provide relevant information. In doing so, enterprises ought to consider that the perception of usefulness and the use of such reporting are highly specific to the target group. To identify key issues, enterprises may engage in stakeholder dialogue. This can be done in several ways, for example by community panels, staff surveys, industrial relations, consumer surveys, opinion polls, workshops with combined stakeholder dialogues on specific issues, and meetings with external experts. Another method is providing stakeholders with contact details and/or comment or feedback forms in published reports or by employing company websites to encourage stakeholders to give input about the information they are interested in and about their opinions on the company's behavior.²

9. Presented below are key stakeholder groups and their information needs:

- (a) Investors and financial institutions;
- (b) Business partners;
- (c) Consumers;
- (d) Employees;
- (e) Surrounding community;
- (f) Civil society organizations; and
- (g) Governments and their institutions.

¹ Freeman RE (1984). *Strategic Management: A Stakeholder Approach*. New York, Pitman.

² For example, the "Tell Shell" portion of the Shell Group's website www.shell.com.

10. This list mainly comprises groups already identified as users of financial reports, for example by the International Accounting Standards Board.³ It is expected that the inclusion of corporate responsibility information into annual reports would not only provide existing users with additional useful information, but would also broaden the scope of users to include additional stakeholder groups with a particular interest in the impact of the enterprise on society.

11. **Investors and financial institutions:** The financial markets consist of various stakeholders, including shareholders, lenders, banks, rating agencies and analysts. While there are differences with regard to the information requirements of these entities, there is nevertheless a growing recognition within this stakeholder category of the importance of non-financial information, including corporate responsibility information, in the evaluation of long-term enterprise performance. The differences that do exist are largely dependent upon the time-frame of the various investor groups: whereas short-term investors may not take much interest in corporate responsibility reporting, long-term investors, such as pension funds, are increasingly interested in such reporting in order to better judge future opportunities, risks, legal liabilities, and the general quality of management. Additionally, there are factors beyond time-frame driving demand for more reporting on these issues. For example, there are non-financial pressures on pension fund trustees to align the social values of pension fund beneficiaries with the social performance of the companies in which the fund invests.⁴ Another example would be the growth of “socially responsible investment” funds that base their investments on social and environmental information, as well as financial information.⁵

12. Non-financial performance indicators are taken into account by financial institutions when valuing companies, in particular from the perspective of risk assessment. In general, financial institutions seek information enabling them to assess both the current and future performance of an enterprise. Typically, they are not primarily concerned with improving corporate responsibility issues; rather, their concern is about the material impact these issues can have on the valuation of a company.

13. Corporate responsibility information required by the financial sector includes the financial consequences of such issues, the overall strategy of an enterprise, its risk and reputation management, compliance with laws and regulations, the consequences of plant additions or closures and similar decisions. In benchmarking exercises (for example, when financial institutions select enterprises for inclusion in social–ethical investment funds or indices) information needs to be presented in a way that allows comparisons.

14. **Business partners:** Business partners include potential or existing joint venture partners, suppliers and customers. They are particularly interested in the enterprise from the point of view of business relationships. Enterprises that use corporate responsibility reporting as part of the due diligence on a future business partner, or a target of future merger or acquisition, need information that enables them to assess risks that might impact the enterprise’s operations. They would like to know how the enterprise addresses corporate responsibility

³ The International Accounting Standards Board identifies users of general purpose financial statements in its framework. It includes present and potential investors, employees, lenders, suppliers and other trade creditors, customers, Governments and their agencies and the public. IASB (2005). *Framework for the Preparation and Presentation of Financial Statements*. www.iasb.org.

⁴ The United Nations Environment Programme Finance Initiative project, the “The principles for responsible investment” is a reflection of non-financial pressures driving demand for social reporting (www.unpri.org).

⁵ Further information on socially responsible investment (SRI) funds in the United States, for example, can be obtained from the Social Investment Forum, an SRI industry association (www.socialinvest.org).

issues, including labour practices, human rights, legal compliance and fair business practices (e.g. anti-corruption, anti-trust, respect for contracts, technology transfer, fair pricing and timely payment of invoices). This information should relate to both the enterprise as well as the key business partners making up the extended value chain of that enterprise. An important element of this information would be disclosure on governance and management systems in place to address corporate responsibility issues.

15. **Consumers:** Consumers are interested in information on product safety measures, the effect of products on health, product quality, product liability and warranty, new product development, and the manufacturing process of products. Interest in the manufacturing process includes information about the circumstances in which products are produced, for example, information on working conditions. Consumers would not be limited to “present and future”, but would also include former consumers who have a stake in product liability and product warranty issues arising from past purchases.

16. **Employees:** An enterprise’s present and future employees are interested in remuneration, plans and intentions of the business, job prospects, working conditions, health and safety, industrial relations, the management of risks, and personnel development opportunities. An enterprise’s former employees, to the extent that they receive pension and other retirement benefits from the enterprise, also have an interest in the enterprise’s present and future financial condition. Trade unions, as representatives of employees, already have access to employee-related information, at least for those enterprises with which they are affiliated. However, they may still find disclosure on employee issues useful to benchmark against other enterprises, industries or countries.

17. **Surrounding community:** Issues related to economic development are often the primary area of interest for an enterprise’s surrounding community. This includes questions about jobs, contributions to the tax base, and the secondary impact of an enterprise (through local business linkages and the multiplier effect of the local payroll). Equally among a community’s primary interests are issues related to the management of local health, safety and security risks and information on community complaints about corporate activities and how these are dealt with. In regard to security risks, communities have a natural interest in positive corporate contributions to the avoidance of human rights abuses, especially in the assurance that armed enterprise security is the subject of proper training and supervision. In some contexts, the local community may also have concerns about the impact of an enterprise’s operations on local culture. Such impacts can result from the introduction of new products or services, or from the generation of internal migration.

18. **Civil society organizations:** Civil society organizations, especially activist and relief-oriented non-governmental organizations, use the information in corporate responsibility reports, among other things, as a basis for dialogue with the reporting enterprise. The interest of civil society organizations covers a wide range of corporate responsibility issues, including labour practice, human rights, anti-corruption, economic development and environmental protection. Civil society organizations are particularly interested in information that allows for benchmarking, or relative comparison, of an enterprise’s performance in this area. They also seek information on corporate responsibility policy and implementation.

19. **Governments and their institutions:** Governments are interested in the way in which enterprises assume responsibilities toward society, in the voluntary initiatives of enterprises in this field and in the impact of enterprise’s social

engagement. Governments need such information to help them formulate social and economic policies, as well as to help identify gaps in regulation and enforcement. Some government offices also use such information to influence their choice of suppliers.

II. Criteria for the selection of core indicators

A. Quality characteristics

20. Drawing a parallel to the existing financial reporting framework that provides principles underlying the usefulness of companies' reported information, the following quality criteria should be taken into account in selecting indicators that meet the common needs of a wide range of users of corporate responsibility reporting:

- (a) Comparability;
- (b) Relevance and materiality;
- (c) Understandability; and
- (d) Reliability and verifiability.

21. **Comparability:** Users should be able to compare the indicators over time and between enterprises to enable them to identify and analyse the outcome of changes in policy and management. For purposes of comparison over time, it is important to disclose corresponding information for the preceding periods. If changes are made in the measurement, presentation or classification of information, comparative figures should be adjusted, unless it is not practical to do so. The reason for a change should be explained by means of notes, and where it is not practical to adjust comparatives, the reason for that should also be explained, as should the nature of the changes that would be required.

22. **Relevance and materiality:** To be useful, information should be relevant in meeting the needs of users in forming an opinion or decision. Information has the quality of relevance when it influences the opinion or decision of users by helping them to evaluate past, present or future events, or confirming or correcting their past evaluations.

23. The relevance of information is affected by its nature and materiality. In some cases, the nature of the information alone is sufficient to determine its relevance. In other cases, both the nature and materiality, as expressed in the relative quantitative variables, is important. Relevance, moreover, often depends on the circumstances relating to topics and recent events. Therefore, it could be relevant to provide more details such as a breakdown by a specific category or other details in relation to some of the indicators.

24. Information is material if its omission or misstatement could influence users' decisions. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, it provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful. If enterprises choose not to include an indicator due to materiality considerations, the enterprise is encouraged to state the reasons why.

25. There is presently still much discussion as how to develop further guidance on a consistent application of the concept of materiality as it relates to non-

financial reporting.⁶ The management of the enterprise is responsible for making adequate decisions with respect to the application of the materiality principle and its effects on the content of its corporate responsibility reporting. The decision-making process of the enterprise's management in relation to materiality should preferably have a structured and substantiated process that is consistently applied to determine what information it considers to be of material importance and therefore for inclusion in its reporting. This could include (a) internal consultations with responsible officers, supervisory boards and/or audit committees; (b) identification of and consultations with important stakeholder groups; (c) considerations of particular issues that play a role in politics and public debate associated with an enterprise's activities, products and locations; and (d) specific industry reporting guidelines. This decision-making process about reporting materiality should be sufficiently transparent and understandable for third parties, and preferably be disclosed in the reporting of an enterprise.

26. **Understandability:** The information on corporate responsibility must be understandable to the reader. This means that the manner of presentation has to be in keeping with the knowledge and experience of users, and should include the following: (a) a good design; (b) systematic classification of topics and indicators; (c) concise use of language; and (d) an explanation of unknown terms in the text, or the inclusion of a glossary to enhance understandability. Relevance takes priority over understandability, but the two concepts should not be seen as mutually exclusive. Information about complex matters that is relevant to users is not to be omitted merely on the grounds that it may be too difficult for some users to understand. For a proper interpretation, these indicators would have to be reported in the appropriate context, such as information on related policies, management systems and past performance. It would also be helpful to make use of targets, both for measuring past performance relative to past targets and for providing forecasts of future performance.

27. **Reliability and verifiability:** Information has the quality of reliability when it is free from material error and bias, and when it gives a true, complete and balanced view of the actual situation. The information should be faithful and representative of the actual situation in the business, complete within the boundaries of what is relevant, well-balanced on both positive and negative events, presented in the right context, and free of material misstatement. It should be neutral (free from bias). Corporate responsibility reporting is not neutral if, by the selection or presentation of information, it influences the making of a decision or judgment in order to achieve a predetermined result or outcome.

28. The indicator selected should allow for internal or external verification. The indicator should enable comparison with underlying evidence.

B. Guiding principles

29. ISAR (during its twenty-first and twenty-second sessions) identified the following five principles that could be used in selecting core indicators on corporate responsibility reporting:

- (a) **Universality to maximize comparability:** The indicators would in principle apply to all enterprises, regardless of sector, size or location, the intention being to maximize the comparability of reported information.

⁶ See, for example, the deliberations of the United Kingdom Department of Trade and Industry in the publication, *The Operating and Financial Review Working Group on Materiality: A Consultation Document* (www.dti.gov.uk).

- (b) Incremental approach: This means that selected indicators should first address issues that an enterprise has control over and for which it already gathers, or has access to, relevant information.
- (c) Capability of consistent measurement: The selected indicators should be able to be recognized, measured and presented in a consistent way. This enables comparison over time and across entities.
- (d) Performance orientation rather than process orientation: The selected indicators should assist users of corporate reports to identify areas of corporate responsibility that require attention, and to measure the performance of the organization in addressing these areas. The social impact of business operations cannot be assessed solely on the basis of the management processes and policies adopted by enterprises in the context of corporate responsibility.
- (e) National reporting and positive corporate contributions to development: Indicators should help to analyse positive corporate contributions to the economic and social development of the country in which it operates. For this reason, indicators should be reported on a nationally consolidated basis, so that they are useful to stakeholders within a specific country, and so that the indicators can be understood within the context of a specific country. In the selection of the indicators, consideration was given to UNCTAD's work on corporate contributions to development (TD/B/COM.2/EM.17/2).

C. Constraints

30. ISAR recognized (during its twenty-first session) the following constraints in selecting core topics and indicators on corporate responsibility reporting:
- (a) Costs and benefits: The measurement of indicators and the provision of additional information in relation to indicators should not impose an unreasonable burden on enterprises, particularly those in developing countries and in the small and medium-sized enterprise sector. The incremental approach helps to address this issue through a focus on indicators that can be derived from data that enterprises already gather or have access to in their regular course of business, without incurring significant additional costs.
 - (b) Confidentiality: The confidentiality of commercial information is often a crucial practical consideration for the success of an enterprise. Therefore, the selection of indicators should respect the confidentiality of commercial data, as well as the confidentiality of any enterprise data that relates to the right to privacy of natural persons (e.g. employee data). However, if a particular indicator is deemed to be material to the needs of stakeholders, then materiality could take precedence over commercial confidentiality, where this does not conflict with legal requirements to keep the information confidential.
 - (c) Timeliness: If there is undue delay in the reporting of information, it may lose its relevance. Conversely, if the reporting is delayed until all aspects are known, the information may be highly reliable but of little use to users who have had to make decisions in the interim. For the timeliness (and hence frequency) of reporting, the enterprise has to find a balance between relevance and reliability. The overriding consideration in this respect is how the information needs of users can best be met.

III. Conclusion

31. In accordance with the agreed conclusions of the twenty-third session of the group of experts, the UNCTAD secretariat is presenting for consideration by the twenty-fourth session of ISAR this report on corporate responsibility reporting with a view towards finalizing ISAR's guidance on voluntary disclosures in this subject area. ISAR may choose to integrate this document with the detailed reporting methodology presented in the document TD/B/COM.2/ISAR/38 and disseminate the combined work as a voluntary technical tool on corporate responsibility reporting in annual reports. A technical tool such as this could be used by enterprises in improving their corporate reporting, by other organizations working on corporate responsibility reporting to further inform their work, and as a benchmark for research on corporate disclosures in this area.

Annex

Eco-efficiency indicators

- (a) Water consumption per net value added;
- (b) Global warming contribution per unit of net value added;
- (c) Energy requirement per unit of net value added;
- (d) Dependency on ozone-depleting substances per unit of net value added; and
- (e) Waste generated per unit of net value added.

For more information on eco-efficiency indicators, please see the UNCTAD publication *A Manual for the Preparers and Users of Eco-Efficiency Indicators* (UNCTAD/ITE/IPC/2003/7).
