



ETHOS ENGAGEMENT PAPER

Sustainability Reporting
Best Practice for
Listed Companies

The Ethos Foundation was founded in 1997 and includes more than 100 members in majority Swiss pension funds. The Foundation's aim is to promote sustainable development and good corporate governance in fund management.

The Foundation fully owns the company Ethos Services, which carries out all investment and consultancy activities. In particular, it offers

- fund management that takes account of sustainable development criteria into account.
- the exercise of shareholder voting rights, including a comprehensive service of proxy

voting analyses with voting recommendations and administrative support for the vote.

- constructive engagement with listed companies. Several years ago, a number of pension funds joined together and mandated Ethos to engage in dialogue with the largest Swiss listed companies on topics of general interest to investors, such as corporate governance and sustainable development.

Ethos is also a member of various international institutional investor groups that are actively involved in dialogue with companies, such as the Carbon Disclosure Project (CDP), the Institu-

tional Investors Group on Climate Change (IIGCC), the Pharma Shareowners Group (PSG) and the Extractive Industries Transparency Initiative (EITI).

Moreover, Ethos is a member of the European Sustainable Investment Forum (Eurosif) and the International Corporate Governance Network (ICGN).

In 2009 Ethos won the ICGN Award for its major positive impact on corporate governance in its region.

www.ethosfund.ch

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SUMMARY

Long-term investor efforts to incorporate environmental and social information into guidelines have been hamstrung by the lack of comprehensible and comparable data. Sustainability reporting among corporations remains mainly voluntary and incomplete, and is often inconsistent.

This paper is based essentially on guidance documents published by the Global Reporting Initiative and provides companies with key insights, principles and general guidelines on sustainability reporting that meet long-term investor expectations.

Ethos urges listed companies to report on environmental, social and governance issues in

accordance with the third edition of the Global Reporting Initiative guidelines and more specifically against the core and the sector specific indicators set out by the Global Reporting Initiative. These voluntary Guidelines are today used worldwide by more than 1,500 corporations worldwide and are widely recognised as the highest standard in the field of sustainability reporting.

WHY REPORT ON ENVIRONMENTAL AND SOCIAL ISSUES?

Companies are increasingly prompted by internal and external stakeholder concerns and expectations to disclose not only financial information but also social and environmental data. In particular, long-term and institutional investors like Ethos express a growing need for environmental and social data that help them value companies comprehensively and take informed investment and proxy voting decisions. Giving investors relevant information on where the company stands in terms of material environmental and social challenges should be the main purpose of a good, fair-balanced and consistent sustainability reporting.

Corporations should therefore communicate on the environmental and social issues they face in addition to providing the usual financial reports. Environmental and social issues have to be discussed in detail with reference to the concepts and strategies that are traditionally used in financial reports to explain how the business works and why it will succeed.

Ethos strongly recommends that listed companies regard environmental and social information as an integral part of statutory and legally required financial reporting, even if there is still no legal requirement to provide it. Because legislation in other countries already requires corporations to report on non-financial matters, failure to provide such reports can place Swiss companies at a potential competitive disadvantage.

Ethos is confident that sustainability reporting will contribute significantly to maintaining or, in some cases, rebuilding long-term investor trust in the corporation.

Global Reporting Initiative (GRI)

The Global Reporting Initiative (GRI) is a network-based organization that has pioneered the development of the world's most widely used sustainability reporting framework and is committed to its continuous improvement and application worldwide. www.globalreporting.org

What is long-term success?

As published in 2008 by the International Corporate Governance Network (ICGN), a global investor coalition, in its Statement and Guidance on Non-Financial Business Reporting, "Long-term success in managing a business in today's complex economic, environmental and social landscape is increasingly dependent on factors not reflected in financial statements and in some instances thought to be outside the corporation's sphere of concern." The ICGN statement identified such factors as "intellectual capital, human capital, the environment, customer goodwill, reputation, human rights, anti-corruption, suppliers and community relations." www.icgn.org

HOW TO COMMUNICATE TO INVESTORS?

1. FORMAL COMMITMENT FROM THE CHAIR OF THE BOARD OR CHIEF EXECUTIVE OFFICER

Ethos attaches a great importance to corporate leadership's endorsement of the sustainability strategy. Without management's proactive support, the entire reporting process and philosophy are likely to be perceived as lacking in credibility and legitimacy.

1.1 STATEMENT OF COMMITMENT

The statement of commitment to sustainability should preface all reports. It should outline the issues management thinks are critical and how the company plans to address them in the near and long term. The statement should also demonstrate the company's awareness of sustainability and its determination to live up to the corporate principles associated with sustainability.

1.2 SUSTAINABILITY STRATEGY GUIDANCE

Above all, the statement must specifically address and explain the relevance of the link between the company's sustainability strategy and its overall business strategy. It must discuss in particular the extent to which the sustainability strategy helps support and strengthen the company's licence to operate, its competitive advantage of the company and its overall economic and financial performance. For instance, the statement should address developments that might harm public health or the environment, involve ethical lapses or spawn labour and human rights abuses.

The statement should also refer to current and upcoming key market trends and scientific developments that are of resonance to the company's brand or reputation, or can result in legal liabilities or affect shareholder value. Examples of broader market trends where environmental and social performance can affect the com-

pany are the emergence of new regulations, shift in customer demand to eco-friendly products and services, requirements for traceability, rising civil society expectations, key commodity prices, industry approaches to customer acquisition and enhancing customer loyalty.

2. MANAGEMENT OF MATERIAL SUSTAINABILITY RISKS AND OPPORTUNITIES

Long-term investors want to understand the opportunities and risks inherent in the business activities of the company in which they invest. The company's performance, reputation or licence to operate can be impaired by a wide range of environmental, social and governance risks and opportunities, depending on the sector of activity and broader sustainability trends in the market. Such risks and opportunities generally fall into the following main categories:

- Physical risks and opportunities
- Regulatory risks and opportunities
- Commercial risks and opportunities

In addition to identifying these risks and opportunities, the company's overall sustainability strategy should prioritise them and encompass policies and procedures for tackling the environmental and social challenges they present.

Sound sustainability reporting should integrate three key elements, which, according to Ethos, represent three successive significant steps that enhance the credibility and effectiveness of the whole reporting process.

1. Commitment at the top

Top-level management's commitment to sustainability must be based on an explicit statement from the Chair man of the Board or the Chief Executive Officer

2. Management of environmental and social issues

Environmental and social risks and opportunities, as well as their impact on business strategy and financial performance, have to be identified and discussed

3. Reporting

Sustainability performance must be reported with adequate environmental and social performance data, quantitative targets and key performance indicators

A sound sustainability strategy also creates a comprehensible link between the risks and opportunities identified and the positive or negative impact on the company's business. It should therefore specify how the policies and procedures implemented have led to obtain and/or consolidate material benefits, e.g. increase in brand value, lower employee turnover, reduced costs, new market shares.

Companies face sustainability challenges all along the chain of value creation, e.g. supply chain, production, use of products and services. The strategy should therefore address opportunities and risks as they pertain to the whole chain of value creation.

Lastly, the sustainability strategy should be as forward-looking as possible. It must therefore mention not only the short-term risks and opportunities, but also what, in the company's view, will be the most significant long-term risks and opportunities.

3. REPORTING ON SUSTAINABILITY PERFORMANCE

The most important part of a sustainability report is the disclosure of environmental and social data illustrating the company's sustainability performance. In order to be comprehensive, the report has to describe sustainability governance. It must discuss the sustainability management system in place and clearly indicate where responsibility for sustainability matters lies by providing organisa-

tion charts or describing key functions relating to sustainability management.

According to the Global Reporting Initiative Guidelines, sustainability reports should comply with two separate sets of principles that allow companies to issue user-friendly reports that meet reader expectations and analysis needs.

The first set of principles is designed to help companies define the report's content (the relevant topics and performance indicators). The second set aims to ensure quality and credibility. The main Global Reporting Initiative principles are presented on the following page.

3.1 CONTENT OF THE REPORT

Financial and non-financial materiality

The information in a report should cover topics and indicators that reflect the company's significant economic, environmental and social impacts. According to the Global Reporting Initiative, materiality is the threshold at which an issue or an indicator becomes sufficiently relevant that it should

be reported. In this regard, any factor that contribute either positively or negatively to the broader goals of sustainable development should be selected and reported on.

Stakeholder inclusiveness

The sustainability report should also focus on issues that affect or are influenced by the company's main stakeholders, e.g. employees, investors, suppliers, local communities, media, customers, NGOs. It must balance the different expectations and interests at stake and respond to those that are more pressing. In addition, the report may explain how the company identified its main stakeholders and engaged them in a consultation process.

3.2 QUALITY OF THE REPORT

Accuracy

Depending on the nature of the information and the objectives set by reporting companies, the information provided can take many forms and be more or less detailed. It may range from narrative reporting on issues and dilemmas, via information on management approaches, to disclosure of

Financial and non-financial materiality of environmental and social data

Investors identify companies in which to invest on the basis of a wide range of individual data. Materiality is the threshold at which an issue or an indicator becomes sufficiently relevant, not only in financial terms but also with regard to non-financial issues, for it to be reported. In this respect, any factor that contributes either positively or negatively to the broader goals of sustainable development should be selected and reported on.

more concrete performance data, which must be the standard. In this regard, quantitative data on performance are particularly welcome since they give a clearer picture of the corporate sustainability performance than qualitative data. Furthermore, quantitative data and targets are more readily understood and easier to compare.

Comparability

The information must be presented in a format that enables investors to compare and grasp company performance over time. The application of this core principle also allows for comparison between companies and is very useful for benchmarking performance and assessing the company's progress. This implies that the reporting company should aim to be as consistent as possible and use the same methodology and layout for sustainability-related information and standardised data from one year to the next.

Balance

Transparency is crucial, and the report should therefore reflect and discuss the negative as well as the positive aspects of the company's performance. In order to be trustworthy, it must not

hesitate to mention any failures or setbacks that occurred during the year under review. It should focus on the solutions defined to solve the problems. Some sustainability reports even include a section incorporating constructive criticism from academic experts or NGOs.

Reliability

The shareholders must have absolute confidence in the information provided, which should therefore be collected, recorded, compiled, analysed and disclosed in a way that can be submitted for verification. In this respect, it is the best practice of some of the largest listed companies to have their sustainability reports verified by an external assurance provider. Publishing an assurance statement at the end of the sustainability report definitely meets the highest investor expectations with regard to best practices.



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