# ICGN Statement and Guidance on Non-financial Business Reporting

# Preamble

The aim of the ICGN Statement and Guidance on Non-financial Business Reporting is to emphasise its importance within the overall context of company reporting and promote better understanding by setting out disclosure criteria that will assist companies in meeting the expectations of investors. As such, the ICGN Statement and Guidance aims to generate substantive dialogue between investors and company boards about the content and timing of non-financial business reporting.

The ICGN Statement and Guidance has been developed by the ICGN Non-financial Business Reporting Committee in consultation with ICGN members. The first draft was published on 31st March 2008 and a consultation paper on the subject was sent to ICGN members for comment. A wide range of responses were received and contributed towards the final draft.

There was further consultation at an open meeting of the Non-financial Business Reporting Committee with ICGN members at the 2008 ICGN Annual Conference and AGM in Seoul, Republic of Korea. ICGN members attending the AGM voted to approve the draft document, after which the final draft was ratified by the membership by email. In December 2008 the ICGN Statement and Guidance on Non-financial Business Reporting was published and launched at an ICGN meeting in Wilmington, Delaware.

The ICGN Non-financial Business Reporting Committee recognises the work of existing bodies seeking to advance non-financial business reporting and will engage with such bodies to promote consistency and broad stakeholder acceptance. The aim is to co-ordinate existing efforts and thereby, in due course, lead to a single reference point for companies. This will promote a cohesive view of investor needs, and provide a more compelling incentive for companies to embrace the key principles of non-financial business reporting.

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# 1. ICGN Statement on Non-financial Business Reporting

## 1.1 Introduction

The ICGN considers that it is part of the fiduciary duty of institutional investors, such as pension fund trustees and fund managers who are agents for beneficiaries, to take into account all of the information which assists in identifying and mitigating risk on the one hand, and assists in identifying sources of wealth creation on the other. To perform that duty adequately shareowners and investors require comprehensive financial and non-financial disclosure by investee companies.

The ICGN position on disclosure and transparency is set out in the 2005 'ICGN Statement on Global Corporate Governance Principles' as follows:

*"Corporations should disclose relevant and material information concerning the corporation on a timely basis, in particular meeting market guidelines where they exist, so as to allow investors to make informed decisions about the acquisition, ownership obligations and rights, and sale of shares."*

The ICGN believes that reporting of relevant and material non-financial information is an essential part of the disclosure required to enable shareowners and investors to make informed investment decisions. We use the term 'non-financial' to refer to information relevant to the assessment of economic value, but which does not fit easily into the traditional accounting framework. Other terms such as 'extra-financial' are also sometimes used to describe this information (see Annex 1 regarding terminology).

In a fast-changing, globalising world, information material to investor decision-making is becoming increasingly diverse and dynamic. 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 same is true for investors when assessing a company's present and future valuation and ability to understand its opportunities and risks. For example, until recently, climate change drew little attention among investors and financial analysts. Today, the confluence of accepted scientific evidence, the pricing of environmental impacts (e.g. through carbon trading schemes), more rigorous financial models and the surging volume of venture capital

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investments in climate-friendly technologies attest to the rapid penetration of climate change into financial markets. Similarly, a company's approach to intellectual and human capital may have material consequences for reputation, capacity to innovate, brands, alliances and other intangible assets that are critical to value creation in the contemporary knowledge and information based economy.

These and other issues, including supply chain management, human resources, and environmental management systems, represent a growing class of variables that drive company performance and valuation. All can have an impact directly on short and long-term value creation and destruction. They can have an impact indirectly through effects such as reputation loss or enhancement and customer satisfaction and loyalty. Non-financial business information, when combined with financial information, can provide valuable insight into the overall quality of management, a critical variable in the appraisal of the firm's financial prospects.

## 1.2 Disclosure and transparency

The ICGN encourages companies to report the information necessary for responsible investment decision making. This is based on a proper understanding of the company's strategic objectives, as well as the financial and non-financial risks and opportunities which may affect its ability to meet those objectives.

Companies in different industries, sectors and social contexts will face different material and relevant issues. Shareholders and investors should seek, and companies should provide, information about the factors which enable investors to judge future prospects as well as past performance.

Non-financial business reporting contributes to achieving the objectives of disclosure and transparency as described in the 'ICGN Statement on Global Corporate Governance Principles.' However, it should not be considered in isolation. It is important that all disclosure integrates consideration of financial and non-financial risks and factors which may affect the company's ability to achieve its strategic objectives.

Sustainability reports serve as a useful purpose for multiple stakeholders in informing the wider community, but issues material to investors should be set out succinctly in the annual report prepared and/or approved by the board itself, and addressed to shareholders. This will demonstrate that directors regularly take non-financial issues into account.

Non-financial issues that may be material include: the impact of environmental risk, such as climate change; matters affecting employees, customers, suppliers and

host communities; the development and protection of intellectual property and other intangible assets which are crucial to success; ethics, and governance arrangements. Other non-financial matters which are relevant may be company or sector-specific. For example, reporting by pharmaceutical companies may include information about the multi-year drug development pipeline, while retail companies may report on same-store sales.

## 1.3 The quality of reporting

Standardised reporting within and between companies greatly assists investor decision making and comparative analysis. The ICGN welcomes efforts to develop acceptable common understanding, standards and guidance for disclosure and reporting to support the financial statements which are being pursued by international standards-setting bodies such as the International Accounting Standards Board (IASB) and the wider corporate reporting community. The value of qualitative and quantitative reporting alongside the financial statements should not be underestimated, nor the importance of judgement in ensuring the relevance of non-financial business reporting.

The ICGN considers that non-financial business reporting should:

- be genuinely informative and include forward-looking elements where this will enhance understanding;
- be material, relevant and timely;
- describe the company's strategy, and associated risks and opportunities, and explain the board's role in assessing and overseeing strategy and the management of risks and opportunities;
- be accessible and appropriately integrated with other information that enables investors to obtain a whole picture of the company;
- use key performance indicators that are linked to strategy and facilitate comparisons;
- use objective metrics where they apply and evidence-based estimates where they do not;
- be strengthened where possible by independent assurance that is carried out having regard to established disclosure standards applicable to non-financial business reporting, such as those issued by the IASB.

The above examples used to illustrate these guidelines are not by any means an exclusive list. They are designed only to illustrate the need for high standards of non-financial business reporting which, when combined with conventional financial reporting, will enable well-informed investment decision making.

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# 2. ICGN Guidance on Non-financial Business Reporting

## 2.1 Background

Conventional financial reporting primarily describes what has already occurred, for example, revenues, net earnings and depreciation of assets during a specified time period. These are essential to understanding a company's financial results and condition at a point in time. However, traditional accounting is generally transaction focused and ill-equipped to capture intangible drivers which in the modern economy increasingly underpin value creation. The so-called 'value gap' between more traditional financial accounting measures of value, such as book value on the one hand and market capitalisation on the other, suggests a need to go beyond conventional accounting. Investors need to understand what drives value.

Non-financial business reporting can help to inform the investment process by revealing in both quantitative and qualitative terms those drivers that increasingly shape company performance. The existence of the 'value gap' suggests that investors understand the potential importance of non-financial business reporting in making investment decisions, and the issue is whether this process can be made more efficient and whether it might benefit from comparable metrics. Efficient asset allocation depends on the ability to compare companies within sectors and ultimately across sectors and this requires a degree of standardisation of definitions.

To complement the information provided by traditional accounting, non-financial business reporting should provide information that helps put historical performance into context, and portrays the risks, opportunities and prospects for the company in the future, be that two, five or ten years or even longer in certain industries. It has an important role in mitigating the short-termism that currently afflicts financial analysis and other approaches to valuation and in helping investors understand a company's strategic objectives and its progress towards meeting them.

Non-financial business reporting should seek to reflect the complexities inherent in a contemporary business - the interdependence of financial and non-financial factors on its prospects; management's understanding of this interdependence; its ability to harness this for value creation; and awareness of the risks and opportunities that flow from non-financial factors.

While failure to recognise these risks and opportunities may not immediately translate into financial outcomes, this is

unlikely to be true in the long-term, which is the time horizon of greatest concern to institutional investors and their beneficiaries.

## 2.2 Expectations of non-financial business reporting

Different stakeholder groups and interested parties have different needs and expectations about the nature of information relevant to their decision making, depending on the issues of particular concern to them. Investors seek information about how a company creates financial value and deals with issues including governance, environmental, social and ethical issues that can affect its financial performance and value over time.

It is increasingly recognised that relationships with key stakeholder groups including customers, employees, and communities can affect the company's financial performance and future value. In other words, an intangible business value, positive or negative, may be attributed to a company's relationships with its stakeholders.

Care needs to be taken to make sure that measures selected are relevant to the specific circumstances of the business. It is useful for investors seeking to compare the performance of different companies in a sector if businesses provide information on performance against measures that are widely accepted in the sector concerned. It is also generally helpful for information to be provided on how the measures have been developed and for a consistent approach to be adopted from one year to another so that changes in performance over time can be evaluated.

Critically, businesses need to recognise the link between improvements in non-financial areas and in cash flow or the share price. Such improvements can occur after a time-lag which highlights the importance of relevant non-financial measures as they may act as a lead indicator of future performance. It is also important to avoid measuring too many things leading to a wild profusion of peripheral, trivial or irrelevant measures.

## 2.3 Basic requirements from a shareowner and investor perspective

The ICGN recognises that there is a need to balance corporate disclosure with protection of commercially sensitive information. The purpose of setting out guidance on non-financial business reporting from a shareowner and investor perspective is to indicate to companies the type of reporting which is useful and to encourage the investment community to solicit such information.

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Bearing in mind that non-financial business reporting should be both quantitative and qualitative in nature, disclosures that are valuable to long term investors will:

- be genuinely informative and include forward-looking elements where this will enhance understanding.

Non-financial business reporting should support and enhance the information in the financial statements. It will set historic performance in the context of a company's strategy and market conditions and will offer insight into the potential for future success. Such forward-looking elements include trend data that can help investors to assess the company's strategy and prospects. Where forward-looking and historical non-financial business reporting is provided, it should explain how it helps to form an assessment of the company's strategy and prospects. For example, does it indicate significant trends that are not evident from the financial statements and, if so, how these trends are likely to affect the company?

- be material, relevant and timely.

Non-financial business reporting is material if it might reasonably be expected to affect investors' decisions about the acquisition and sale of shares or the exercise of ownership rights and obligations. Non-financial business reporting should be timely, in particular meeting market guidelines and it should be made available as soon as reasonably possible so that investors are able to make informed decisions based on it and the likelihood of a false or distorted market is diminished.

Information should be focused in order for it to be genuinely useful. Too much information that is not relevant will dilute the message. The materiality (or not) and relevance of the issues covered will be determined by the company's circumstances and the sector within which it operates, rather than being determined by a prescriptive approach to what should be reported.

- describe the company's strategy, and associated risks and opportunities, and explain the board's role in assessing and overseeing strategy and the management of risks and opportunities.

The explanation should focus on the key points necessary to help investors understand not only the strategy, risks and opportunities but also form a view of the appropriateness and effectiveness of the governance approach adopted by the board in its oversight of these matters.

- be accessible and appropriately integrated with other information that enables investors to obtain a whole picture of the company.

Non-financial business reporting should be in a form which shareowners and investors can reasonably be expected to understand. For example, complicated technical terms should be explained and care should be taken to ensure that the information is clearly written and presented. It should be appropriately integrated with and presented alongside financial information in companies' reports to shareowners.

- use key performance indicators that are linked to strategy and facilitate comparisons.

An indicator is likely to be important and relevant to strategy if it is used by the board in monitoring the company's performance in achieving its strategy and if it is therefore likely to affect board decisions. However, for non-financial business reporting to achieve its potential to assist in efficient capital allocation, it could be argued that consistent definitions and industry norms may be needed for certain metrics even if they are not used by management.

Indicators disclosed in non-financial business reporting should facilitate comparisons with other companies and for the same company over time. Where sector-specific practices have emerged for indicators, companies should follow them unless they have reasons for considering them inappropriate. Companies should disclose indicators that are comparable over time, unless circumstances change and they cease to be appropriate.

- use objective metrics where they apply and evidence-based estimates where they do not.

Where objective measures of intangibles are relevant and can be obtained, such measures should be used. In the absence of relevant objective measurements, estimates and commentary should be provided. Narrative discussion and judgement can be useful in conveying information. Both metrics and judgement are valuable in non-financial business reporting.

- be strengthened where possible by independent assurance that is carried out having regard to established disclosure standards applicable to non-financial business reporting, such as those issued by the IASB.

Independent assurance about the extent to which non-financial business reporting has followed established measurement and reporting standards can be useful to enhance the credibility and reliability of the reported information. Companies should adopt a clear and disclosed policy towards obtaining assurance.

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# Annex 1: Terminology

Non-financial business reporting is a wide-ranging term which can include both regulated and voluntary disclosure by companies. From a shareowner and investor perspective, it is information, other than financial statements, which is relevant and material to investment decision making. This may include descriptive information around a company's operation and strategy or other disclosures which may bear on intangible assets and value drivers, and the company's "social license to operate". Other terms such as 'extra-financial' and 'narrative reporting' are sometimes used to describe such information.

The United Nations' Principles for Responsible Investment (UNPRI) encompass a significant subset of the terms covered by non-financial business reporting. In this regard, the UNPRI has adopted the term, Environmental, Social and Governance (ESG) which covers factors that investors, who wish to be seen as 'Responsible Investors', should take into account and equally, ESG disclosures expected of companies. 'Corporate Social Responsibility' or simply 'Corporate Responsibility' are widely used terms encouraging positive corporate social and environmental practices and, inter-alia, their disclosure as part of non-financial business reporting.

Some companies have responded to these various demands for additional disclosure by producing "Sustainability Reports" either as part of their annual reports to shareholders or as stand alone reports.

In recent years, many companies have embraced various forms of non-financial business reporting, notably in terms of their environmental and social impacts. In Europe and Japan, there has also been experimentation with various types of intellectual capital statements. However, there is as yet no generally accepted definition of what constitutes non-financial business reporting, though significant progress has been achieved.

In a welcome initiative, the IASB in 2008 began to develop non-mandatory guidance for a narrative report described as 'Management Commentary'. The IASB aims to develop the principles, qualitative characteristics and essential content elements necessary to make Management Commentary useful to investors. This is an important step towards achieving global consensus on non-financial business reporting whilst recognising diverse legal, cultural and regulatory environments in different jurisdictions.

# Annex 2: Metrics

Credible and verifiable measurement of non-financial business reporting is vital. However, the development of valid metrics is challenging due to a variety of factors including the measurement of intangibles, claims of proprietary information, and comparability across qualitative data elements. The metrics for non-financial business reporting will frequently be determined by the specific characteristics of a company and the sector in which it is operating. However, there is a growing consensus on a number of components that will have widespread relevance across multiple sectors.

The ICGN Non-financial Business Reporting Committee's own deliberations, as well as the work of other interested groups, highlight a number of broad subject areas as being integral components of non-financial business reporting. These include not only corporate governance, which is a central focus of the ICGN's mission, but also areas such as intellectual capital, human capital, the environment, customer goodwill, reputation, human rights, anti-corruption, suppliers and community relations.

These areas may themselves be redefined or reshaped over time as the field of non-financial business reporting evolves often in line with developments in legal and regulatory requirements and emerging views about topics such as workplace, social and ethical practices in the field of non-financial business reporting. The impact of global and economic trends should be also taken into account. Often the impact of such trends is immediate on the financial reporting side, but they also have a long term impact on corporate sustainability and value.

The ICGN aims to encourage companies to develop and use metrics which suit their particular circumstances while pointing to the value of developing consensus around components which allow for comparison. It aims to help foster such a consensus without prescribing any particular solutions.

# Annex 3: Resource list

Some examples of useful guidance documents, standards and studies relating to non-financial business reporting, including those recommended by ICGN members who responded to the consultation on the subject, are listed below. Further examples will be available in due course on the ICGN website at www.icgn.org.

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## International references


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- The Norwegian Society of Financial Analysts, ‘Recommended guidelines for the reporting of additional information on value creation’
- Universities Superannuation Scheme, James O’Loughlin and Raj Thamotheram, ‘Enhanced analytics for a new generation of investor’
- US Securities and Exchange Commission, ‘Management’s Discussion and Analysis of Financial Condition and Results of Operations’

# Annex 4: Acknowledgments

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# Annex 5: Contacts

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