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Part F: Corporate Social Responsibility and Business Ethics

Chapter F1

Sustainability

Sustainability F1.5

Dr Chris Moon, who wrote this section, was the founder of CSR Global where he was a Director. He is a member of the Tomorrow's Company Climate Change Group and was a member of the Steering Group for the Conference Board Europe Climate Change Conference in Autumn 2007. Chris can be reached at chris@csrglobal.co.uk (tel: +44 (0)845 057 3776; mobile: +44 (0)783 810 3435) or visit www.csrglobal.co.uk.

The moral and commercial imperatives of climate change for business

Climate change poses severe threats to the planet and all activity on it. Carbon dioxide and temperature levels are unprecedented, global population and energy use are soaring, polar ice caps are melting, and natural disasters are increasing[1]. Other predicted impacts cited in the Tomorrow's Company report into the business implications of climate change include: 150 million environmental refugees by 2050, the warming effect of the Gulf Stream switching off, and 25% species extinction in the next 50 years.

This section was submitted by Dr Chris Moon, Head of Sustainability Services, Green Your Office, co-founded in partnership with Anita and Gordon Roddick. Chris is also founder of CSR Global and formerly Head of Sustainability for the UK operations of an international company. He is an award-winning social and environmental entrepreneur, member of the Conference Board European Council on Corporate Responsibility & Sustainability and member of Tomorrow's Company Climate Change Group. He can be contacted at chris@greenyouroffice.co.uk or chris@csrglobal.com.

The moral imperative of climate change is clear – the very existence of life on the planet. The commercial imperatives of climate change are less clear – the very nature of business could have to be redefined. This short article outlines the need for a new business narrative on climate change, new business metrics and the need for sustainable innovation. The Association of British Insurers' Guidelines on Responsible Investment Disclosure 2007, reproduced at **F1.6**, provide a structure for identifying appropriate board responses to the climate change agenda.

Climate change agenda for business – at a glance

Boardroom challenge	**Board response**
Board takes account of the significance of environmental, social and governance (ESG) matters to the business of the company.	Sustainability likely to be placed at core of governance policy. This is likely to lead to major policy and framework changes.
Board has identified and assessed the significant ESG risks to the company's short- and long-term value, as well as the opportunities to enhance value that may arise from an appropriate response.	Existing ESG systems need to be updated in light of climate change risks identified. Climate change to be regarded as a significant material risk.
Board has received adequate information to make this assessment and that account is taken of ESG matters in the training of directors.	Directors need to increase their awareness of climate change issues and attend workshops on climate change to consider impacts on the company. Internal and external audit information is likely to be required to make informed and verifiable policy decisions. Energy, waste and carbon audits likely to become the norm.
Board has ensured that the company has in place effective systems for managing and mitigating significant risks, which, where relevant, incorporate performance management systems and appropriate remuneration incentives.	Various instruments can be used to help implement effective systems. These can include international, national and sector-specific instruments. Some provide substantive standards, others are process standards. Companies will need to select instruments that best meet their needs (see below).
Annual reporting requirements	**Implications for business**
Annual report includes information on ESG-related risks and opportunities that may significantly affect the company's short- and long-term value, and how they might impact on the future of the business.	Business Review (arising from the EU Accounts Modernisation Directive) has replaced the Mandatory Operating and Financial Review (OFR). Companies are required to provide ongoing narrative, description of principal risks, financial and non-financial KPIs, and views on trends and factors affecting the company.

Annual report includes a description of the company's policies and procedures for managing risks, and the possible impact on short-and long-term value arising from ESG matters. If the annual report and accounts states that the company has no such policies and procedures, the board should provide reasons for their absence.	Business Ethics has been considered critical enough to be integrated into corporate governance, as evident with the shift in emphasis from SEE to ESG risks. Climate change is also likely to be integrated across company policies, codes and procedures.
Annual report includes information, where appropriate using key performance indicators (KPIs), about the extent to which the company has complied with its policies and procedures for managing material risks arising from ESG matters and about the role of the board in providing oversight.	The most forward-looking companies are likely to regard carbon as the new metric. This will need to be measured, monitored and reported on annually along with other greenhouse gases (GHGs) as appropriate. All directors, though, will need to report on compliance with the sustainability policy and action plans drawn up for their area of operations. KPI data and narrative will be required as will actions taken by the board to tackle issues and problems that arise.
Annual report should describe the procedures for verification of ESG disclosures. The verification procedure should be such as to achieve a reasonable level of credibility.	Verification of disclosures can be gained internally and/or externally to the company. Internal verification on company codes and their implementation benefits from insider knowledge of the company, but can lack independence. External verification can provide an independent view but lack insider knowledge. Credibility will come from getting the right balance of in-house and external expertise – financial and non-financial.
Remuneration report should consider corporate performance on ESG issues when setting remuneration of executive directors. If the report states that the committee has no such discretion, then a reason should be provided for its absence. The remuneration committee should ensure that the incentive structure for senior management does not raise ESG risks by inadvertently motivating irresponsible behaviour.	Accounting for sustainability means not just accounting for profit but how that profit is achieved. If the new metric is to be carbon then remuneration should be partly based on achieving carbon reduction targets. The ABI Remuneration Guidelines are a useful starting point.

Boardroom challenges

Tomorrow's Company recommends redefining business success in terms of lasting positive impacts for business, society and the environment[2]. The most forward-looking companies will regard sustainability as an opportunity to innovate. Thus new eco-products and services will be developed and more eco-efficient operations. The starting point should be the question: how can we make our product or service and our company 100% sustainable?

Boards will need to ensure that they are adequately aware of climate change issues and that all directors are willing and competent enough to redefine business success and concomitant strategy, policies and procedures. For example, directors will need to become conversant with 'whole-life-cycle' analyses and 'cradle-to-cradle' strategies.

Climate change is already being regarded as a material risk. The extent of that risk will vary company to company. However, all asset owners will need to address the impacts of climate change. Business risks of climate change include the physical risk of property damage, regulatory risk of carbon compliance regimes, and commercial risks of competitors developing new or alternative low-carbon products and services.

International instruments can be used to help create new frameworks. To take some examples:

- the UN Global Compact can be used for over-arching principles;
- the International Labour Organisation's (ILO) charters provide a basis for codes of conduct;
- ISO quality, environmental and proposed CSR standards can be used to develop management systems;
- the Global Reporting Initiative can be used to provide foundation and sector-specific reporting standards;
- AA1000 can be used as a process standard for stakeholder dialogue.

Other instruments are useful to help manage specific risks. These include:

- SA8000, France's Initiative Clause Sociale (ICS), UK's Ethical Trading Initiative (ETI), USA's Fair Labor Association (FLA) and European Business Social Compliance Initiative (BSCI); these can all be used to review issues of human rights and manage labour conditions in the supply chain;
- the Responsible Care Charter in the Chemical Sector, Responsible Apparel Production (WRAP), Electronic Industry Code of Conduct (EICC), International Council of Toy Industries Care Process (ICTI) are all industry-specific schemes.

The best starting point as regards climate change is to develop a company-specific sustainability policy. Clearly this policy and its implementation will have ramifications across all areas of the business and all directors will need to be prepared to draw up and support energy, waste and carbon reductions plans as a result.

Annual reporting

Accounting will increasingly be for sustainability, the narrative of reports will be about climate change and the new metric will be carbon and other GHGs. This has significant implications for the content, scope and style of annual reports. Many companies will simply carry on with business as usual and fail to adapt their reports to the climate-change agenda. However, increased scrutiny of investors, regulatory bodies and NGOs will mean that such companies will increasingly be sidelined on green procurement grounds. Investors will want to invest in companies actually tackling the climate-change agenda and providing verifiable evidence of doing so. Government and NGOs will want to ensure that national and international targets are being met.

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Some companies have already produced separate social or environmental reports. However, the standard of these can vary enormously. These reports can be useful. However, increasingly they will form a basis for disclosures in the annual report, where significant risks need to be identified. Climate change is already impacting on companies large and small and all boards and directors will need to ensure that they have the necessary skills and expertise to identify and manage such risks.

Notes

1 Tomorrow's Company: the challenges and choices. Climate Change – the role of global companies (www.tomorrowscompany.com).

2 Tomorrow's Global Company: challenges and choices (www.tomorrows company.com).