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# European Union regulatory requirements relating to Sustainability Reporting. The case of Sweden

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**Key words:** sustainability reporting, CSR, regulations, Directive 2006/46/EC, GRI Guidelines

**Abstract**

In this paper the issues of sustainability reporting and particular the regulations in the European Union in this field are presented. In connection with the annual increasing number of published sustainability reports the question raises of whether the practice should be voluntary or mandatory – regulated by law? The first part of the article discusses the existing regulations in the European Union in this area. The second part presents an example of the solutions adopted in one of the Member States.

## Introduction

Sustainability reporting is becoming a global standard and popular practice [1, 2, 3], especially among large companies [4]. The European Union is the most active region in the world in terms of sustainability reporting. According to GRI statistics, 45% of published worldwide sustainability reports in 2010 year came from Europe. Therefore, a question arises whether the practice should be voluntary or mandated by regulations, if so, to what extent? Current EU legislation addresses the disclosure of non-financial information, in particular the Fourth Company Law Directive on annual accounts. Several Member States (including the UK, France, The Netherlands, Sweden and Denmark) have introduced disclosure requirements that go beyond the Fourth Company Law Directive. Certain Member States have made the disclosure of nonfinancial information mandatory. Others have adopted a "comply or explain" regime, which requires companies either to disclose non-financial information or to explain the reasons for not disclosing [5].

Terminology most frequently used for these kinds of practices in literature and business practice are: triple bottom line reporting, corporate responsibility reporting, Environment, Social and Governance reporting (ESG reporting), non-financial disclosures. In this paper the author accepted that these terms are equivalent and uses them interchangeably. The article is divided into two parts. The first part of the paper consist of literature review and is an overview of existing regulations in the European Union relating to the reporting on sustainable development issues. In the second part the author presents the case study of solutions adopted in one of European Union country. The analysis presented in this paper has been prepared under the project funded by the National Science Centre Poland awarded on the basis of a decision number 2011/03/B/HS4/01790.

## Literature review

Over the past decade there has been a lively debate amongst proponents of voluntary [6, 7, 8] and mandatory [9, 10, 11] reporting standards. Ten years ago corporations usually argued strongly in favour of voluntary standards whilst NGOs, pressure groups and trade unions demanded mandatory standards since they did not believe that corporations would disclose material information objectively unless they were required to do so by law. As always there are arguments for and against, both for mandatory and voluntary reporting (see Table 1). During the last few years the debate has become

Table 1. Reasons for and against mandatory and voluntary approaches to sustainability reporting [12]

| Approaches to reporting | Reasons for | Reasons against |
|---|---|---|
| Mandatory | • Changing the corporate culture – leaders will continue to innovate above minimum requirements<br>• Incompleteness of voluntary reports<br>• Comparability<br>• Non-disclosure of negative performance<br>• Legal certainty<br>• Market failures – theory of regulation<br>• Reduction of non-diversifiable market risk free rider problem<br>• Cost savings<br>• Standardisation<br>• Equal treatment of investors | • Knowledge gap between regulators and industry<br>• One size does not fit all<br>• Inflexibility in the face of change and complexity<br>• Lack of incentive for innovation<br>• Constraints on efficiency and competitiveness |
| Voluntary | • Flexibility<br>• Proximity<br>• Compliance<br>• Collective interest of industry | • Conflicts of interest<br>• Inadequate sanctions<br>• Under-enforcement<br>• Global competition<br>• Insufficient resources |

more mature. There are now companies, investors and analysts that are promoting regulation, and trade unions that use voluntary standards amongst their members [12]. Voluntary sustainability reporting, while increasingly recognized for its valuable contributions, presents a number of challenges. For example, companies reporting on a voluntary basis may [13]:

- Choose different time periods in which to report – some may report annually, some biannually, some at irregular intervals, and some only once and then not at all;
- Report on different indicators— companies in the same industry may choose to report on the variety of different key indicators;
- Report in different formats and using different metrics – even when reporting on the same indicators, companies may report data covering different time periods, using different units of measurements, or choosing different benchmarks against which to measure performance.

In cases when sustainability reporting is voluntary, it may be easily seen by companies as non-essential and therefore be either reduced or fully abandoned [14]. Mandatory sustainability reporting promotes socially responsible managerial practices [10]. However, it has its own drawbacks, such as boilerplate style reporting to meet minimum requirements. Without proper monitoring and enforcement, reporting could be rendered meaningless and result in a waste of time and resources for all parties [14]. Regulating the reporting practices do not always improve the communication process and quality of the disclosed information. In some cases companies with passive or indifferent corporate environmental strategies will focus on reducing their reporting costs in order to meet the regulatory requirements by neglecting the quality of data and information in their information management procedures. This leads to an adverse selection in reports whereby bad information quality drives out good information quality [15], with the effect that the figures and statements are of little or no information value to stakeholders [16]. The arguments most often made against mandatory reporting, and in favor of continuing the current regime of voluntary reporting, are typically ones of practicality and costs – it is difficult for regulators or stock exchanges to determine what data should be required and how to monitor the adequacy of its reporting; and it is expensive for companies to compile sustainability data [13].

Despite all the arguments for and against governments are key players in the sustainability debate and in the promotion of sustainability reporting [17]. One option is for the regulator to be passive and let sustainability reporting emerge as the result of market forces. Alternatively, the regulator may choose to introduce a range of measures to supplement the market forces [10]:

- through regulations dictating mandatory reporting by firms;
- by providing incentives for companies to report;
- governmental endorsement of the GRI Guidelines and material encouragement for adoption;
- by recommending or proposing voluntary guidelines with or without reference to international standards such as the United Nations Global Compact (UNGC) and GRI;
- by transferring the regulatory power to self-regulating authorities like a stock exchange, whose statutes may be either voluntary or mandatory.

Different types of public policy instruments in promoting corporate social responsibility (CSR) concept can be identified. R. Steurer [18] proposes five categories of such instruments:

– legal instruments: regulations, directives, public procurement etc.;
– economic and financial instruments: taxes, tax credits, subsidies, awards, etc.;
– informational instruments: campaigns, branding, training, conferences, etc.;
– partnering instruments: networks, stakeholder dialogues, Public Private Partnerships, etc.;
– hybrid instruments: combination of two or more types of the above instruments. CSR centres, for instance, can be both informational and partnering, and CSR action plans usually consist of all four types of instruments.

Across countries, different combinations of the above options have been implemented in recent years. There is a large variety of regulatory choices and there is a visible trend in governments' activity to regulate sustainability reporting today. Of the more than 140 national standards on voluntary and mandatory approaches to sustainability reporting, selected in 30 countries, roughly two thirds are mandatory [12]. It is worth mentioning that many of the voluntary standards are issue by national governments (Government Ministries). Often governments prefer to use "soft power" [19] first before they legislate. Moreover, they aim to provide guidance to companies without having to pass through a cumbersome parliamentary procedure. Soft measures often have the way for harder measures, e.g. legislation. In this sense, voluntary standards are not only complementary, but they can also have a pre-law function [12].

Existing regulations with implications for sustainability reporting in European Union are discussed in the next section of this paper.

## Regulations in European Union with Implication for Sustainability Reporting

In recent years, the number of companies publishing sustainability reports has increased significantly in the world. According to statistics, at the global level, this number has increased from almost zero in 1992 to 9,653 today (corporateregister.com database). Despite the fact that these figures show a significant increase, it is necessary to bear in mind that reporting companies are still a small proportion of the total number of enterprises in the world. The level of corporate social responsibility – CSR reporting in different countries varies. Europe and especially its western part is the most active region in the field of CSR reporting (see Fig. 1).

Moving to the subject of sustainability reporting it must note that the interaction between business and society in Europe is shaped by the diversity of

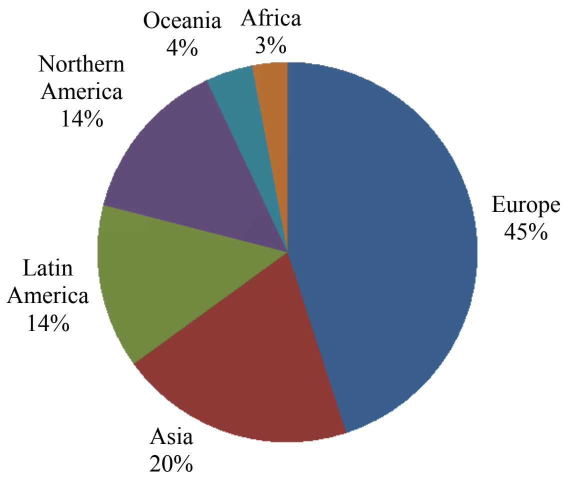


Fig. 1. Regional distribution of 2010 sustainability reports [source: Global Reporting Initiative Statistics]

economic, political and cultural landscapes across the continent. The idea that companies can contribute to societal well-being beyond their legal obligations has a long tradition in many parts of the region. In general, the development of CSR concept has been driven by proactive strategies adopted by pioneering businesses, European institutions and national governments, as well as by external pressures from other stakeholders such as civil society and the investor community, among others [20]. The approaches to CSR vary in different European countries [21]. In Central and Eastern Europe, in contrast to Western Europe, mainly companies themselves (often foreign multinational corporations) are the agents of change, whereas external pressure from civil society, media and public authorities has so far been fairly low [22]. At the European Union level, no legislation on CSR as such has been introduces, but existing EU and national regulatory frameworks cover a wide range of issues related to CSR, for instance in the areas of environmental protection, health and safety, and employment practices. Promoting increased transparency and disclosure of non-financial information is also a key issue on the EU agenda. A growing number of companies in Europe are reporting on their sustainability performance as part of their annual reports or in separate CSR reports. In recent years, some European governments have made CSR reporting mandatory for large companies or decided to lead by example by pushing state-owned companies to report on their sustainability performance. As a relatively early example of national reporting requirements, all listed companies in France have had to disclose information on social and environmental conditions in their annual reports since 2001. In the Nordic region, Sweden has made sustainability reporting based on the GRI guidelines obligatory for all state-owned companies as of 2009, and the Danish companies are required to report on their sustainability performance as of 2010 [20].

In the terms of sustainability reporting in the European Union there are several regulatory instruments. Existing regulations apply to both voluntary and mandatory systems, where reporting on sustainable development issues is the part of the compliance with their requirements. It can include to them: the Accounts Modernisation Directive, the European Pollutant Release and Transfer Register (PRTR), the Integrated Pollution Prevention and Control Directive (IPPC), the EU Eco-Management and Audit Scheme (EMAS) and the EU Emission Trading System (ETS). Below the author discusses the various instruments.

It should be noticed here, that not all described in this article regulations are directly aimed at increasing the number of separate sustainability reports or have an impact on the quality of these reports. The presented regulations very often are general laws with reference for companies to report on sustainability issues in their annual or financial statements and do not always leads to a typical sustainability report.

The EU Accounts Modernisation Directive 2003/51 [23] amended the Accounting Directives and stipulates that from reporting year 2005 onwards European companies "shall to the extent necessary for an understanding of the development, performance or position, include both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters". Member States may choose to exempt small and medium-sized companies from those non-financial reporting obligations with regard to their annual reports. Another amendment of the Accounting Directives (Directive 2006/46) introduced an obligation for listed companies to include a corporate governance statement in their annual report. By November 2009, all Member States have transposed the Modernisation Directive and most of the Member States have transposed Directive 2006/46 (literally) in their national laws [12]. The Modernisation Directive itself does not set any requirements in relation to the type of indicators to be included in the annual report. However, individual EU governments have taken initiatives, in consultation with national stakeholders, to provide companies with further guidance in this regard [23].

The European Pollutant Release and Transfer Register (E-PRTR) Regulation 166/2006/EC came into force in February 2006. The E-PRTR Regulation requires operators of facilities to report on emissions and specific substances. The E-PRTR serves as a Europe-wide register of industrial and non-industrial emissions into air, water, and land, and off-site transfers of waste water and waste, and includes information from specific and diffuse sources. Each EU Member State is required to establish the National Pollutant Release and Transfer Register which is part of the European Pollutant Release and Transfer Register. Facility-level data are public based on the consent of companies. It is closely linked with the implementation of the Integrated Pollution Prevention and Control Directive (IPPC).

The Integrated Pollution Prevention and Control Directive was established in 1996, and requires Member States to lay down permit conditions for operators to control, monitor and report emissions from IPPC installations. All industrial and agricultural activities with a high pollution potential are required to have a permit. Member States also have to provide data on implementation to the Commission. Data reported under the IPPC flows into the E-PRTR database [24].

The European Emission Trading System (ETS) [25] launched in 2005, is a cornerstone of the European Union's policy to combat climate change and the key tool for reducing industrial greenhouse gas emissions cost-effectively. Being the first and biggest international scheme for the trading of greenhouse gas emission allowances, the EU ETS covers some 11,000 industrial plants in 30 countries (the 27 EU Member States plus Iceland, Liechtenstein and Norway). The EU ETS works on the "cap and trade" principle. The number of allowances is reduced over time so that total emissions fall. In 2020, emissions from sectors covered by the EU ETS will be 21% lower than in 2005. The EU ETS has shown that it is possible to trade in greenhouse gas emissions: emissions from installations in the scheme are falling as intended. The EU hopes to link up the ETS with compatible systems around the world to form the backbone of a global carbon market. Article 14 of the EU ETS Directive (Directive 2003/87/EC) requires the Commission to adopt guidelines for the monitoring and reporting of greenhouse gas emissions under the ETS. The Article also requires Member States to ensure that operators of installations and aircraft operators monitor and report their greenhouse gas emissions in accordance with these Monitoring and Reporting Guidelines (MRG), which are legally binding.

The EU Eco-Management and Audit Scheme (EMAS) [26], 1995, is a management tool for companies and other organisations, requiring them to evaluate, report and improve their environmental performance. It is a kind of voluntary standard but when a company will decide to implement EMAS it is required to report on its environmental performance. The scheme has been available for participation by companies since 1995 (Council Regulation (EEC) No. 1836/93 of 29 June 1993) on a voluntary basis. Originally it was restricted to companies in the industrial sector, but since 2001 it has been open to all economic sectors. It was revised in 2009 (Regulation EC No. 1221/2009). This revision came into effect on 11 January 2010. One of the aims of this revision was to strengthen the rules on reporting through core performance indicators. It states that organizations should make periodic environmental statements publicly available, and in order to ensure relevance and comparability of the information, reporting on the organizations' environmental performance should be on the basis of generic and sector specific performance indicators.

Going back to the Modernisation Directive during the last few years all Member States have integrated its requirements, and most of them have transposed Article 46 into national law. A survey carried out by the Federation of European Accountants in 2008 showed the following results [27]. All twenty one Member States that answered the survey have included Article 46 of the Modernisation Directive literally into their national legislation. All surveyed countries have implemented the four elements specified in Article 46:

– A fair review of the development and performance of the entity's business and of its position, together with a description of the principal risks and uncertainties that it faces;
– The review shall be a balanced and comprehensive analysis of the development and performance of the entity's business and of its position, consistent with the size and complexity of the business;
– To the extent necessary for an understanding of the entity's development, performance or position, the analysis shall include both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters;
– In providing its analysis, the annual report shall, where appropriate, include references to and

Table 2. Instruments with mandatory and voluntary implications for sustainability reporting in Sweden

| Instruments with mandatory implications for sustainability reporting in Sweden | |
|---|---|
| Name | Requirements |
| Annual Accounts Act (ÅRL, Chapter 6) | The amendment to the Annual Accounts Act, 1999, states that certain companies have an obligation to include a brief disclosure of environmental and social information in the Board of Directors' Report section of the annual report. The Annual Accounts Act (Årsredovisningslagen) was updated in 2005 to include that certain companies have to include even more non-financial information in the Board of Directors' Report section of the annual report. This update is a result of the implementation of the Accounting Modernisation Directive (2003/51/EC) in Swedish legislation [12]. |
| Guidelines for external reporting by state-owned companies | The guidelines for external reporting of the state-owned companies include the annual report, interim reports, the corporate government report, the statement on internal control and the sustainability report. All state owned entities in Sweden are from the 1 January 2008 required to present an annual sustainability report based on the Global Reporting Initiative Guidelines. The sustainability report is to be subject to independent assurance [32]. |
| The Swedish Environmental Code | Act of 1998 on the Swedish Environment Code, entered in force in 1999, introduces the requirement to disclose information in an annual environmental report on the environmental consequences of their activities for companies in the construction sector and those having activities emitting toxic waste for the environment [33]. The Environmental Code is the first integrated body of environmental legislation enacted in Sweden. The purpose of this Code is to promote sustainable development which will assure a healthy and sound environment for present and future generations. The Environmental Code is applicable to all citizens and economic operators who undertake operations or measures that conflict with the objectives of the Code [34]. |
| Instruments with voluntary implications for sustainability reporting in Sweden | |
| Name | Requirements |
| Guidelines on environmental information in the Directors' Report section of the Annual Report | The Swedish Accounting Standards Board (Bokföringsnämnden) provides guidelines on environmental information in the Directors' report section of the annual report [12]. |
| FAR SRS standard RevR6 "Independent assurance of voluntary separate sustainability reports" | This standard was issued by The Swedish Institute for the Accountancy Profession (FAR) and is used by accounting firms providing sustainability assurance for Swedish companies. It was the first national standard in the world when it was issued in 2004. The standard was updated in 2006 to comply with International Standard on Assurance Engagements (ISAE 3000) [35]. |

additional explanations of amounts reported in the annual accounts.

Nineteen out of the twenty one countries surveyed used the Member States option to exempt small entities from the obligation to make certain non-financial disclosures. This option was not taken up by Lithuania, Portugal or Spain. The Netherlands and France provide additional guidance in relation to the implementation of the Modernisation Directive.

In next section the author presents a case study of EU member state which implemented additional requirements concerning non-financial reporting (see Table 2).

## Case studies of non-financial disclosure in Sweden

In order to realize the level of maturity of sustainability reporting in particular country it is important to know the context of CSR concept development there. The author chooses to analyze one of the EU member state with a considerable experience in practicing corporate social responsibility concept: Sweden. At the beginning a brief overview of the CSR concept development is presented and the way how EU Modernisation Directive is implemented into national legislation. Next the author presents instruments with mandatory and voluntary implications for sustainability reporting and discusses the results of the research on the effects that the government's reporting requirements actually have had on the companies' sustainability practices.

Sweden has the reputation of being a leader in actively promoting corporate social responsibility (CSR). It seems that the success is mainly due to the government which plays an active role in coordinating policies in this area and integrating them into trade and foreign policy strategies [28]. In 2004 a strategy was adopted for sustainable development (Swedish Strategy for Sustainable Development), which was further supplemented in 2006 by document Strategic Challenges – a Further Elaboration of the Swedish Strategy for Sustainable Development [29]. It comprises issues relating to CSR and indicates that companies should contribute to sustainable development through their development and growth which does not have a negative impact on society and the environment. In 2005 State Ownership Policy was adopted, which pointed to the need to build ethical and environmental policies by the companies [30]. The CSR and sustainability issues are politically located in the Ministry for Foreign Affairs and the Minister for Trade. Consequently the discussion in Sweden tends to circle around issues such as supply chain, human rights, anti-corruption and the environment. Also health issues often come up, but in that context people think of global problems such as HIV/AIDS or malaria rather than health problems within Sweden [31]. The Swedish Government has a unit called Swedish Partnership for Global Responsibility, encouraging companies in working according to the UN Global Compact. Sweden also has an officially appointed "CSR Ambassador". The Swedish Partnership for Global Responsibility encourages Swedish companies to embrace CSR and serves as a platform for businesses, labour unions, and non-governmental organisations to work together [31]. The cultural context in Sweden could also helped to play a part. Sweden, like other Nordic countries, has a strong culture of environmental protection and sustainability. The Swedish culture of consensus could also be another reason for CSR success – people like to engage others in making decisions via consensus, and are good listeners – the signs of good stakeholder engagement in CSR [28].

The other main reason for the success of CSR in Sweden is that big Swedish companies are taking responsibility voluntarily. Many Swedish companies have sustainability reports and the companies listed on the stock exchange provide sustainability reports on a voluntary basis. The stock exchange in Sweden does not require CSR reporting nonetheless about 75% of Swedish companies do reporting as part of corporate transparency [28]. The survey carried out by KPMG on International Corporate Responsibility Reporting in 2011 found that Sweden is one of the leading countries, with 72% of its top 100 companies reporting on their corporate responsibility activities.

Sweden has transposed the Modernisation Directive in its national law in 2005 in Chapter 6 of the Annual Accounts Act (see Table 2). In 2007 the Swedish government adopted the guidelines for external reporting by state-owned companies. Sweden is the first country which demands sustainability reports from state-owned enterprises. From the 1 January 2008 all state owned entities in Sweden are required to present an annual sustainability report based on the Global Reporting Initiative Guidelines. These guidelines are based on the principle of "comply or explain", which means that a company can deviate from the guidelines if a clear explanation and justification of this departure is provided. This design enables the guidelines to be applicable and relevant to all companies, regardless of size or industry, without having to abandon the main purpose of the accounting and reporting. A sustainability report in accordance with the GRI guidelines shall be published on the respective company's website in conjunction with publication of the company's annual report. The sustainability report can either be a separate report or an integrated part of the annual report document. The sustainability report shall be quality assured by independent scrutiny and assurance. The date for publication of the report shall be in compliance with the reporting cycle for the annual report [32].

In 2007, the Swedish government introduced new guidelines requiring state-owned companies to provide sustainability reports in accordance with the Global Reporting Initiative (GRI). The reform was part of an active ownership policy of the Swedish government with an ambition to promote sustainability in state-owned companies.

At the end of 2009, the Ministry of Enterprise, Energy and Communications commissioned Uppsala University, Department of Business Studies to investigate the effects that the government's reporting requirements actually have had on the companies' sustainability practices. The research was built on a questionnaire which was sent to 49 Swedish state-owned companies and interviews with a sample of the companies. The response rate was 76 per cent. The findings are as follows:

The report requirements have led to 1) increased commitment and awareness of sustainability issues, 2) more structured work and more structured processes and 3) sustainability issues have risen up the agenda and been given higher priority by managements and boards.

The introduction of the new guidelines affected the companies to varying degrees. The companies that lacked previous experience of sustainability reporting (65 per cent of the companies had no experience) have gone through a more extensive process of change than those that were already submitting sustainability reports.

The guidelines contributed mainly to improved procedures for reporting on sustainability issues, rather than bringing about far-reaching changes in sustainability activities in practice.

The reporting of sustainability issues in the first instance strengthens and improves reporting procedures, whereas the next step – to changes in practice – is a greater one.

With regard to GRI: the guidelines have in many cases made it easier for companies to define the sustainability process and responsibility. On the other hand, to act in accordance with the guidelines, especially in selecting the relevant GRI indicators, was regarded as difficult in most cases [33].

## Conclusions

Today it can observe a visible trend in governments' activity to regulate sustainability reporting. Governments are key players in the promotion of sustainability reporting. The regulator may be passive or alternatively choose to introduce a range of public policy instruments in the area. The studies [12] indicate that of the more than 140 national standards on voluntary and mandatory approaches to sustainability reporting, selected in 30 countries, roughly two thirds are mandatory. Regulatory pressures are more often seen as an adequate tool for improving corporate sustainability practices. Sweden is a country of a high CSR awareness and maturity of the concept. The introduction of mandatory reporting by state-owned companies based on the GRI guidelines in 2008 in Sweden has increased awareness and importance of this theme among these companies as well as improved internal processes related to sustainability reporting process. The results of the study [33], however, do not indicate major changes in the sustainability practices of the companies.

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