Integration of CSR issues into Corporate Governance system
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Introduction

This report analyses how Corporate Social Responsibility (CSR) considerations are integrated into the Corporate Governance framework, looking beyond national codes and differences.

Integrating CSR issues into companies' systems of Governance constitutes the basis for a comprehensive inclusion of Environmental, Social, and Governance (ESG) factors into a company strategic planning, decisions and operations. It allows the corporation to develop a strategy behind its CSR choices, to handle social responsibility issues at managerial level, and to monitor and coordinate related operational decisions.

Corporate Governance relates to the corporation’s relationships with not only shareholders, but also all the stakeholders interacting with the company: institutional investors, creditors, employees, suppliers, customers, local communities and all other actors which play a role in contributing to the long term success and performance of the company.

These stakeholders have legitimate interests and expectations from the company. CSR is the company’s integration of these interests in its strategy and business activity. As such, Corporate Governance is not only clearly inserted in the number of key corporate social responsibility areas in which a company can take action, but it represents the key pillar, the decision making level in which the management’s choices in terms of corporate social responsibilities are taken. A company’s long-term performance is linked to reputation, human-capital cohesion and operational efficiency. These elements are closely related to CSR and question executives and board members’ capacity to identify and integrate CSR risks within the company’s strategy and internal control system, as well as in the executives’ incentive schemes.

Vigeo identified six core channels of integration of CSR into corporate governance: two of them referring to the composition and functioning of the board of directors (the integration of CSR issues into Directors’ trainings and the review of CSR issues during board meetings), three of them to the audit and internal controls system (the identification of CSR risk factors using the internal control system, the role of the audit committee in reviewing CSR risks and the external certification of the company’s CSR reporting) and one of them to the executive remuneration’s mechanism (the integration of CSR performance indicators into executive remuneration practices).

A group of 1,223 companies from Europe, North America and Asia-Pacific has been examined within this study. 973 European and North America companies, which report similar levels of information, have been compared in the core analysis. For clarity and to prevent bias, the further 250 companies from the Asia-Pacific region have been separately assessed and discussed.
Key Findings

A CONTRASTED PICTURE

The integration of CSR issues in the Corporate Governance system is a topic on which the majority of companies assessed communicate: 70% of European and North American players report on how they integrate CSR subjects into at least one aspect of their governance system.

Heterogeneous levels of maturity are observed, depending on the channel of CSR integration.

- A majority of European and North American companies appear to take CSR subjects into account at the highest decision-making level since, on average, 64% of the players have published a formal CSR report signed by the senior management or have included substantial CSR information in their Annual Report. However, only 19% of them have at least one non-executive director explicitly in charge of CSR issues at Board level.

- In contrast, only a few leaders have integrated CSR objectives in the executives’ incentives schemes: 2% of the companies under review indicate that executives’ remunerations are linked to quantified indicators reflecting the CSR performance of their organisation.

The level of CSR integration varied across geographical zones.

- European players communicate more exhaustively than North American companies on how CSR issues are discussed at the strategic decision-making level and handled as potential sources of risks: 71% of European companies appear to regularly and formally review CSR issues at board level versus 50% of the North American ones. European companies are also more proactive in integrating environmental, social or governance issues within the perimeter of the internal control system. In addition, they seem to put more emphasis on the reliability of their CSR communication: the rate of certification of CSR reporting is indeed significantly higher for European companies (35%) than for North American ones (5%).

- An opposite trend is observed regarding the alignment of top executives’ interests with stakeholders’ interests and CSR objectives: the share of companies declaring to have linked their executives’ bonuses to clear and quantified CSR objectives is indeed much higher in North-America (5.8% vs 0.2%).

- In Europe, companies showing the highest level of inclusion of CSR issues in their Corporate Governance are those based in the Netherlands and the UK. This might reflect the impact of the national soft law: the leadership of these countries could be explained by the existence of advanced principles of good corporate governance and best practices put forward by the Dutch Corporate Governance Code and the UK Combined Code.

CSR issues that are the most commonly identified as potential sources of risks are environment and health and safety. Indicators most commonly used as targets for executive’s short-term incentives do also refer to these issues.

Eighteen companies out of the 20 that link executive remuneration to CSR objectives set, among others, objectives related to health and safety, while eight of them adopted environmental targets.

Actors operating in sectors having strong and direct impacts on the environment and on employee’s health and safety show a relatively higher level of integration of CSR issues in their governance structures. This might be due to a more straightforward identification of related operational risks. The stringent legislation framing their activities may also increase the legal risks these sectors are exposed to in case of non-compliance.

- The Chemicals, Mining and Metals and Heavy Construction industries are among the sectors where most companies declare to formally review CSR issues at board level.

- Sectors such as Energy, Chemicals and Mining and Metals, are among the best performers in terms of integration of CSR risks in the internal control system.

- The Electric and Gas Utilities and Energy sectors appear to be the most active in the integration of CSR targets in executive remuneration. The Electric and Gas Utilities sector is also the one in which companies use the widest range of CSR targets.

The level of CSR integration varied across geographical zones.

- European companies appear more keen to integrate CSR considerations in the Corporate Governance system than their peers from North-America and Asia-Pacific: a review of the 46 most advanced players in terms of integration of CSR issues into the corporate governance system reveals that 42 of them are based in Europe, while only three are based in the Asia-Pacific region, and one in the North-American zone.

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The 46 top performers report CSR issues to be integrated into four to five of the six identified channels of integration of CSR into Corporate Governance. They are reported in the table below. The table shows the leadership of European companies (42 out of the 46 leading companies are European), with a high presence of British players (21 out of 46 players). Only one company from North America (Nexen) and three from Australia (Stockland, Qantas Airways and Wesfarmers) are amongst the top performers.

<table>
<thead>
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<th>Companies</th>
<th>Country</th>
<th>Zone</th>
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<td>Roche</td>
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<td>Oil Equipment &amp; Services</td>
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<td>France</td>
<td>Europe</td>
<td>Hotel, Leisure Goods &amp; Services</td>
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<td>Europe</td>
<td>Forest Products &amp; Paper</td>
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<td>XSTRATA Plc</td>
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<td>Stockland</td>
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<td>Wesfarmers Ltd.</td>
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<td>Specialised Retail</td>
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1. Global analysis

Vigeo identified six core channels of integration of CSR issues in the Corporate Governance System, namely:

- The review of CSR issues during Board meetings
- The integration of CSR issues into Directors’ trainings
- The identification of CSR risk factors using the internal control system
- The role of the audit committee in reviewing CSR risks
- The external certification of the company’s CSR reporting
- The integration of CSR performance indicators into executive remuneration practices.

The integration of CSR subjects in the Corporate Governance System is now a topic on which the majority of players communicate: 70% of the European and North American companies under analysis report on their efforts to integrate CSR into at least one of the six above-mentioned channels. However, as pictured by the graph above, companies integrating CSR issues in a majority of channels of their governance system account for only 4.4% of the panel and none of the players communicate on all subjects at stake.

When considering each of the above mentioned channels of integration of CSR into the Governance system, the formal review of CSR issues at board meetings appears as the only widespread practice. In contrast, only a minority of companies appear to integrate CSR consideration within the five other aspects of their Governance system. While one fourth of players have their CSR reporting certified by an external party, the integration of CSR consideration in the executive remuneration schemes seems to remain an exceptional practice.
**FOCUS ON ASIA–PACIFIC**

As shown by the graph below, Asia–Pacific companies appear to lag behind European and North American players regarding the integration of CSR issues into their Corporate Governance Systems. Half of the Asia Pacific companies do not appear to include CSR topics in any of the governance practice under analysis, while 49% of them appear to use one to three channels of integration of CSR issues into the Governance system. Only three players (representing 1% of the panel) report to integrate CSR considerations into a majority of channels.

![Level of CSR Integration in the Corporate Governance System, Asia-Pacific](chart)

**Top Performers in the Asia–Pacific Region**

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<tr>
<th>Companies</th>
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The three leaders are from Australia, while the 41 companies from this country represent only 16% of the companies rated in the Asia–Pacific region.
Integration of CSR issues at board level

With regard to the integration of CSR issues at the Board of Directors level, two aspects have been taken into consideration: the review of CSR issues during Board meetings and the training provided to the Board of Directors, on CSR issues relevant to their sector.

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<thead>
<tr>
<th>INTEGRATION OF CSR ISSUES AT BOARD LEVEL</th>
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<tr>
<td>Review of CSR issues during board meetings</td>
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<tr>
<td>Training on CSR issues provided to board members</td>
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**REVIEW OF CSR ISSUES DURING BOARD MEETINGS**

In 2004 the Organisation for Economic Co-operation and Development (OECD) Corporate Governance Principles laid out a CSR mandate for Boards of Directors that suggests these bodies should take stakeholders’ views into account in their decision making and strategy setting. The OECD’s Corporate Governance Principles state that Boards must consider environmental and social concerns: “Another important board responsibility is to oversee systems designed to ensure that the corporation obeys applicable laws, including tax, competition, labour, environmental, equal opportunity, health and safety laws.” In the same spirit, the European Parliament, in its recommendations to the European Commission, states that: “the responsibility of the companies’ executives and directors should include the reduction of any negative impact on social and environmental side of the firms’ activities”.

Directors can evaluate the company’s CSR strategy at board meetings, by reviewing the corporate CSR Report, or through a systematic review of potential CSR-related risks, in conjunction with an internal controls review. The board can ensure that these issues are addressed in a systematic way by assigning responsibility for CSR to one director or by creating a board level CSR committee. Vigeo considers as a best practice that at least one non-executive director be responsible for CSR issues since this will allow an effective control on the CSR strategy implemented by the management.

The graph shows a relatively high level of reporting (64%) on the formal review of CSR issues at board meetings, which reflects a good level of integration of CSR issues in companies’ strategies and decision-making processes. This result, however, conceals different levels of effectiveness: the large majority of companies discloses a CSR report signed by top executives and is therefore considered as carrying out a formal review of CSR issues at board level.

**REVIEW OF CSR ISSUES DURING BOARD MEETINGS – DIFFERENT LEVELS OF EFFECTIVENESS**

| Formal review of CSR issues at Board meetings | 64% |
| Responsibility for CSR issues assigned to a specific committee | 19% |

Yet, only 19% of the players have implemented a dedicated structure (in most cases a board committee composed of one or more non-executive directors), in charge of systematically reviewing the CSR strategy, policies and activities.

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Compared to their North American peers, European companies show a higher level of integration of CSR issues at board level. While a majority of European companies (71.2%) report to regularly and formally review CSR issues at board level, only half of the North American players (50.3%) state to do so. Regarding the existence of a dedicated committee in charge of CSR issues, the ratio is also higher for Europe, (where 23% of players indicate they have set-up such body), than for North America (17%).

**Examples of Best practices**

- At FIAT (Automobiles), the Nominating, Corporate Governance and Sustainability Committee, which is part of the Board, evaluates proposals relating to strategic guidelines for sustainability-related issues, presents, where appropriate, opinions to the Board of Directors, and reviews the annual sustainability Report.

  - At l’Oréal (Luxury Good and Cosmetics), a Strategy and Sustainable Development Committee, including non executive directors is responsible for examining means and resources in the field of Sustainable Development, and reporting on them to the Board. In addition, a Human Resources and Remuneration Committee including one non-executive director is responsible for remunerations and Human Resources policies on matters such as social relations, recruitment, diversity and talent management. This committee is also in charge of overseeing the Code of Business Ethics.

**INTEGRATION OF CSR ISSUES INTO DIRECTOR TRAINING**

Most key national and international Corporate Governance Codes demand that companies offer trainings to board members for enhancing their performance. This is the case, for example, of the European Commission\(^3\) and of the UK “Companies Act” (2006) states that directors have the duty to promote the success of the company for the benefit of its members as a whole and having regard to, among others, the consequences of any decision in the long term. It also requires board members to promote the interests of the company’s employees, foster the company’s relationships with suppliers, customers and other stakeholders, as well as the impacts of the company’s operations on the community and the environment. In addition, an increasing number of European governance codes such as the Spanish and Dutch codes, require companies to integrate CSR as an issue to be dealt with as part of the strategic discussions.

At sector level, the most systematic approaches are observed in the Chemicals, Mining and Metals and Heavy Construction sectors, with respectively 94%, 88% and 80% of companies declaring to formally review CSR issues at Board level. This might reflect a higher level of maturity in the identification of CSR related risks, which may lead to a more systematic management of these issues by senior management.

**Examples of training on CSR issues**

- Training directors on the prevention of corruption or of anti-competitive practices.
- Updating directors on rising environmental issues.
- Updating directors on health and safety risks in the company.
- Yet, this practice appears to be still exceptional. A total of 56 out of 973 European and North American companies (less than 6% of the sample analysed) report to include CSR-related topics in the training provided to their Board of Directors.

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\(^{1}\) Recommendation on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, EC (2005)

\(^{2}\) The Combined Code on Corporate Governance, Financial Reporting Council (2008)

\(^{3}\) Integrating ESG issues into executive pay, PRI (2012)
The analysis per zone reveals a significant gap between North American and European companies, with 7.3% of the European companies taking a pro-active stance versus 2.7% for the North American ones. This gap could be linked to the levels of integration of CSR issues within the Board’s discussion: as European players are keener to discuss CSR subjects at Board level than North American ones, European Board members may require more training and updates on the company’s CSR challenges and performances. At a country level, the two best performers in terms of training on CSR provided to the Board members are the UK and the Netherlands. These countries are also within the top three in terms of integration of CSR as a subject of discussion at Board meetings. The national governance codes appear once again to play a role in determining this performance. The Dutch Corporate Governance Code, for example, states that “the management board and the supervisory board should take account of the interests of the various stakeholders, including corporate social responsibility issues” which should also be included in induction programmes for supervisory board members. This may account for the high rate of integration of CSR issues at Board meetings (78%) observed in this country.

Examples of Best practices
- Catlin Group Ltd (Insurance) and Burberry (Luxury Goods and Cosmetics): these companies report to provide induction training programmes to the Board members that include the presentation of the companies’ key CSR policies and CSR strategy.
- ArcelorMittal (Mining and Metal): the company’s Board of Directors launched in 2009 a continuous education program for its members. The topics addressed in this program included, among others, human resources, corporate governance and legal compliance.
- British American Tobacco (Tobacco): the Board receives training on the Standards of Business Conduct and the CSR Committee receives training on other CSR issues. In addition, new Board members receive an induction from the CSR team.

FOCUS ON ASIA–PACIFIC

Almost half of the Asia-Pacific companies (45.6%) have discussed the approval of their CSR reports during Board meetings, a result in line with the one observed in Europe and North America. However, only two players (Stockland and Qantas Airways) have established dedicated CSR committees within the Board, formalising responsibilities for overview and integration of CSR issues at top level. This represents 0.8% of the panel. Likewise the National Australia Bank (Banks) and Shiseido (Luxury Goods & Cosmetics) are the only companies in the region who report to provide training on CSR issues to their Board members.
Integration of CSR issues within the audit and internal control system

CSR issues can be integrated in the audit and internal controls system through the identification of CSR risks factors using the internal control system, the review of CSR issues by the audit committee, and the external certification of the company’s CSR reporting.

Few players appear to have identified CSR issues as sources of risk that need to be pro-actively managed: only 12.3% of companies under review declare that the audit committee is in charge of overseeing CSR issues, while 15.6% indicate that CSR risks are covered by the internal control system.

A slightly larger group of players appears to consider the reliability and accuracy of CSR related data as an important issue: 25.5% of companies made use of external certification for their CSR reporting.

Integration of CSR issues within the audit and internal control system

Identification of CSR risks factors using the internal control system

Role of the audit committee in reviewing CSR issues

External certification of the company’s CSR reporting

Identification of CSR risk factors using the internal control system

The role of an internal control system is to identify, monitor and address factors that could represent a tangible risk for the company. Usually, companies report on traditional types of risks, such as operational, technological, financial and legal risks. Including environmental, social and ethical factors within the company’s risk management system can be considered a necessary step towards the proactive management of CSR issues as sources of risk.

In addition, the legislation approved in April 2013 by the European Commission⁶ includes an amendment to existing accounting legislation in order to improve the transparency of large companies on social and environmental matters. Companies of more than 500 employees will need to disclose information on policies, risks, and results as regards environmental and social matters, as well as on issues related to the respect for human rights, anti-corruption and diversity on the Boards of Directors. If reporting in a specific area is deemed not relevant by a company, this corporation will not be obliged to report but it will have to explain why this is the case. The proposed measure leaves significant flexibility for companies to disclose relevant information in the way that they consider most useful. Companies may also use international or national guidelines which they consider appropriate.

Since this information will have to be disclosed to the financial authorities, companies will have to ensure data’s accuracy and reliability. Including these data in the internal control system’s perimeter may be the best way to ensure this reliability.

Yet, extending the internal control’s perimeter to CSR issues does not appear a widespread practice: only 16% of European and North American players report to include CSR risks within the internal control system.

When compared to their American competitors, European companies appear to be more pro-active in terms of managing CSR issues as potential sources of risks. 18.3% of them indicate that their internal control system covers at least one type of environmental, social or governance issue, while this is the case for only 10.4% of North American companies. European companies’ good performance is mainly driven by the UK and the Netherlands, where around one company over three integrates CSR risks in the internal control system.

Focusing on the panel’s 10 top performers in terms of integration of CSR issues in their corporate governance system, seven of them clearly indicate that environmental risks are integrated in their risk management system, while health and safety and business ethics related risks are mentioned by six of them. Only two of them mention community-related risks. Among them, Barratt Developments (Home Construction) reports that the risks covered by the internal control system include the impact of the company’s activities on local communities. None of the players clearly refers to human right’s issues.

Best performing sectors in terms of integration of CSR risks in the internal control system, appear to be among those most exposed to environmental and health and safety issues such as, among others, large-scale accidental pollution, adverse impacts on biodiversity and severe or fatal accidents. In the Mining and Metals sector, 44% of the companies state to include CSR risks in the internal control system, while this is the case for respectively 32% and 31% of players in the Chemicals and Energy sectors. One explanation could be that the identification of CSR risks of this kind is rather straightforward in these industries, since severe environmental and health and safety incidents may generate important material consequences for involved companies. This performance could also be linked to the existence of stringent legislations framing the environmental impacts of these sectors, as well as employee’s health and safety conditions, which may increase the related legal risks. It is also worth mentioning that due to these important health and safety and environmental risks, as well as their impacts on local communities, these industries are under high stakeholder scrutiny, which may increase their sensitivity to reputational risks.

Examples of best practices

KAZAKHMYS (Mining & Metals): the company’s internal control group sends regular reports to the Board as well as Health, Safety and the Environment Committee, on health, safety and environmental matters.

Anglo American (Mining & Metals): at the end of 2009, Anglo American has set up a Safety and Sustainable Development team to review and provide assurance on the effectiveness of the internal control system. The team is included in the evaluation of every major capital project. A formalised internal operation review process was introduced in 2010, as part of the asset optimisation programme. Sustainable Development is one of the three functional areas covered by the process, along with operational improvement and technical assessment.

ROLE OF THE AUDIT COMMITTEE IN REVIEWING CSR RISKS

It is the Board’s responsibility to ensure that the company’s internal and external procedures set up to identify and evaluate risks are adequate and soundly applied. An effective Audit Committee should be responsible for the integrity of the corporation’s accounting and financial reporting systems, as several international texts demand, including the OECD Principles of Corporate Governance. In addition to its traditional role, some national codes of Corporate Governance also expect the Audit Committee to oversee CSR risks. This is the case of the Spanish Code that mentions the legal and reputation risks among the ones a company is subject to. This is also what one could derive from the newly approved European Commission Directive on the transparency of largest companies on social and environmental matters.

Yet, including the oversight of CSR issues within the responsibility of the Audit committee remains an exceptional practice: only 12.3% of the companies declare that the Audit Committee is responsible for the oversight of CSR issues.
When considering regional differences, the European region outperforms North America, with 14.3% of European companies reporting on this topic compared to 8.5% of North American players. This result has to be analysed in correlation with previously observed results on the identification of CSR risks factors using the internal control system. Indeed, one of the functions of the Audit Committee is to oversee the risk management system. Therefore, when CSR issues are among the risks identified by the company, their review is often assumed by the Audit Committee.

Examples of best practices

- **AstraZeneca** (Pharmaceuticals & Biotechnology), **Amgen** (Pharmaceuticals & Biotechnology North America) and **Colgate-Palmolive** (Luxury Goods & Cosmetics North America): the Codes of Conducts of these companies include commitments on CSR issues (e.g. human resources, business practices, respect of human rights, etc.) and are overseen by the Audit Committee.

- **Allstate Corp.** (Insurance North America): the company’s Audit Committee is responsible for the company’s traditional operational and financial reporting. This issue is increasingly raised at a national level, as shown by the implementation decree of the French Grenelle II Law (2012) which requires the largest French companies to report on their social, societal and environmental impacts on a yearly basis and have this reporting certified by an external independent actor. The Spanish and Danish legislations from respectively 2011 and 2008 take a similar approach. The European Directive approved in April 2013 also provides a framework to the treatment of this issue in member countries.

Despite increasing demand for the reliability and accuracy of CSR data, only 25.5% of the companies under review have their CSR reporting certified by a third party. Compared to the two other channels of integration of CSR issues within the internal control system, this is however the most widespread practice.

**Examples of best practices**

- **AZA** (Electric and Gas Utilities): the company publishes significant social and environmental reporting, with quantitative indicators, that is audited by a third party.

- **Eiffage** (Heavy Construction): an external auditor reviewed CSR indicators (accident rates, diversity indicators, consumption of energy and water, and waste generation).

- **Barrick Gold** (Mining & Metals): an external auditor was engaged to conduct independent 3rd party assurance of the company’s 2011 Corporate Responsibility Report.

When comparing European and North American players, a significant gap is observed regarding the rate of external certification of CSR reporting: only 5.5% of North American companies report to make recourse to an external body to certify their CSR reporting, compared to 35.7% of European companies. This might reflect a greater emphasis put by European companies on the reliability and credibility of their communication to clients and investor.

The regulatory drive in Europe may also explain this gap, as suggests the example of the French article 225 of the ‘Grenelle II’ law that will require external certification of reporting.

When analysing sector differences, once again, sectors that on average most frequently submit their CSR report for external certification are industries having an operational activity with strong and direct impacts on the environment and on employee’s health and safety. In the Energy, Mining and Metals, and Heavy Construction sectors, respectively 40%, 41% and 66% of the companies have an externally certified CSR report.

**Examples of best practices**

- **Total** (Energy): some environmental and social performance indicators are audited by an external auditor.

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Asia-Pacific companies report significantly less than their peers from Europe and North America on their integration of CSR issues in the audit and internal control system: 2.8% of them report on the CSR risks covered by their internal control system, 5.6% state that the oversight of CSR issues is part of the role of their audit committee and 16% indicate to recourse to an external certification or review of their CSR reporting.

Examples of best practices
- **Wesfarmers** (Specialised Retail): the company indicates that CSR risks are covered by the internal control system and reviewed by the audit committee. In addition, Wesfarmers’ CSR reporting has been reviewed by a 3rd party.
- **CSL** (Pharmaceuticals & Biotechnology): the company’s risk management system covers environment, health and safety, product quality, and security risks.
- **Qantas** (Travel & Tourism): the company’s risk management system covers enterprise-wide safety, health, environment and security risks.
- **OneSteel** (Mining & Metals): the company identifies risks linked to the environment and occupational health and safety as material business risks covered by the company’s risk management system.
- **Cathay Pacific Airways** (Travel & Tourism): the company indicates that risks covered by the internal control system include safety, environmental, and reputational risk.
A well-structured executive compensation plan is essential for good corporate governance: traditionally, this is the mechanism to align the interests of the property (shareholder) and the control (management) of the company. But the executive remuneration plan can also be used to incorporate the interests of a broader range of stakeholders, usually excluded by the normal business conduct: in this context, the integration of CSR performance indicators as direct drivers of executives’ remuneration can be considered a good practice. A remuneration policy which internalises CSR objectives can also reinforce the company’s reputational asset and improve the relationship with both investors and communities. In addition, incentives for sustainability can contribute to improve the company’s social and environmental performance, which may have a positive impact on financial performance in the medium to long term.

The integration of CSR-related performance criteria into executive remuneration is the issue on which companies report the least. A total of 20 leaders out of 973 companies integrate CSR criteria into the remuneration objectives of their top executives and disclose quantitative targets in this respect. This represents 2% of the sample analysed. This could be due to the absence of regulation that explicitly recommends or imposes executive variable remuneration to be linked to CSR objectives. In Europe only the German Corporate Governance Code suggests that the compensation structure should be “oriented towards the sustainable growth of the enterprise”, while the Danish Code recommends to link variable remuneration with the long-term value creation of the company. In Europe and North America, the rising trend of legislation and soft laws on executive remuneration focuses on transparency and the opportunity given to shareholders to express an opinion, rather than on integrating CRS criteria into compensation’s scheme. The “say-on-pay”, in particular, is mandatory since 2013 in the UK and since 2010 in the US. In France, the recently approved new Corporate Governance Code has also introduced a recommendation on the “say on pay” for listed companies.

REGIONAL ANALYSIS

INTEGRATION OF CSR PERFORMANCE INDICATORS INTO EXECUTIVE REMUNERATION

<table>
<thead>
<tr>
<th>Region</th>
<th>Average</th>
<th>NAM</th>
<th>EUR</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2.1%</td>
<td>5.8%</td>
<td>0.2%</td>
</tr>
</tbody>
</table>

12 Integrating ESG issues into executive pay”, PRI (2012)
13 “Recommendations on Corporate Governance”, Denmark, Committee on Corporate Governance, (2010)
14 Recently approved legislations include: the Dodd–Frank Act, USA, (2010); the Enterprise and Regulatory Reform Act, UK, (2013); the “Stock Corporation Act”, Germany, (2009).
If one analyses the integration of CSR objectives in executive’s remuneration by geographical zone, data show a clear predominance of North American companies versus European ones, a result in contrast with the preceding ones. While 5.8% of companies from the North American zone declare to integrate CSR performance indicators in executive remuneration schemes, only 0.2% of European players appear to do so.

**Sector analysis**

If one analyses the integration of CSR criteria in executive remuneration by sector, results show that six out of 36 sectors are active on the issue. Their activity is detailed in the table below.

**Type of CSR indicators integrated in executive remuneration practices in most advanced sectors**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Companies integrating CSR indicators in remuneration practices/total nb of companies in the sector</th>
<th>Type of CSR Targets</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Health and Safety</td>
</tr>
<tr>
<td>Chemicals</td>
<td>1/34</td>
<td>1</td>
</tr>
<tr>
<td>Energy</td>
<td>5/45</td>
<td>1</td>
</tr>
<tr>
<td>Oil Equipment &amp; Services</td>
<td>1/31</td>
<td>1</td>
</tr>
<tr>
<td>Waste Water</td>
<td>1/8</td>
<td>1</td>
</tr>
<tr>
<td>Electric &amp; Gas Utilities</td>
<td>11/57</td>
<td>10</td>
</tr>
<tr>
<td>Automobiles</td>
<td>1/25</td>
<td>1</td>
</tr>
<tr>
<td>Total (6 sectors)</td>
<td>20</td>
<td>18</td>
</tr>
</tbody>
</table>

CSR indicators that appear to be mostly used as targets are related to health and safety and environment: out of the 20 companies that disclose one or more CSR objectives used to determine the allocation of bonus, 18 mention Health and Safety objectives and eight of them report on environmental targets. One indicator to which the attribution of bonuses is often linked is the attainment of a predetermined target level of OSHA (Occupational Safety and Health Administration) recordable injury rate. Environmental targets such as the reduction of CO2 emissions and energy consumption are also among the most commonly used. A more limited number of companies relate executives’ bonus to the attainment of objectives in terms of diversity of the workforce. Finally, some companies operating in the services sectors (Electric & Gas Utilities), particularly those having final retail clients, link their executives’ bonuses to positive results in terms of responsible customers relations (for most of the cases under review, the number or average duration of services-interruption).

CSR objectives to which bonuses are related appear to be directly linked to the company’s operational activity and legal security. Reducing the frequency and severity of accidents may indeed have direct consequences on a company’s legal security, in addition to improving the firm’s reputation and attractiveness as an employer. Likewise, the reduction of energy consumption allows the mitigation of operational costs, especially in energy intensive industries such as the Electric and Gas Utilities or Energy sectors. The ability to provide an uninterrupted service in the Electric and Gas Utilities sector may also have a direct impact on the company’s ability to retain customers.

The 20 best performers belong to industries having strong social and environmental impacts in terms of employees’ health and safety, potential accidental pollution, energy consumption and air emissions. The two most active sectors in the integration of CSR targets in executive remuneration are the Electric and Gas Utilities and Energy sectors. The Electric and Gas Utilities sector is also the one in which companies use the widest range of CSR targets, spanning from health and safety, to environmental and responsible relation with customers. Both the Electric and Gas Utilities and Energy industries are energy intensive and entail high risks of damages to biodiversity and environmental accidents. Employees in these two sectors are also highly exposed to health and safety risks, including fatalities.
As was observed regarding the inclusion of CSR issues within the internal control system, the higher level of maturity seen in these industries might be explained by the stringent legislation and high level of stakeholders’ scrutiny they are subject to. They might also be explained by the direct operational consequences issues such as large energy consumption and severe environmental or safety accidents may have. Companies in these sectors may, therefore, reap strong reputational and operational opportunities in providing CSR-related incentives to their executives.

The academic literature supports this view. As an example Berrone and Gomez explain that “companies in polluting industries face tight governmental regulations, increased media attention and strong environmental activism. Thus, it makes sense that firms should reward their executives for environmental actions that confer greater legitimacy and may directly or indirectly improve firm performance. Firms that operate in environmentally sensitive sectors and have good environmental performance enjoy enhanced social legitimacy and organizational survival capabilities, and reward their CEOs accordingly. That is, they include environmental performance as a criterion in incentive schemes for chief executives”16.

Examples of best practices

- **Constellation Energy Group** (Electric and Gas Utilities): in 2011, bonuses of executives were linked to one financial objective and two CSR objectives: a safety target (the Occupational Safety and Health Administration - OSHA - recordable injury rate, with a target of no more than 1.3 per 200,000 hours worked) and a target related to customers’ relations (an average duration of annual electric system interruptions per customer of no more than 1.35 hours).

- **EnCana** (Energy): in 2011, bonuses of executives were linked to a series of performance criteria including two CSR targets: a safety target (a decrease of total recordable injury frequency rate of 5% from 2009 and zero fatalities in 2010) and an environmental target (a decrease of 18% reportable spills over 2009).

- **Johnson Controls’** (Automobiles): in 2011, bonuses of executives were linked to financial objectives as well as one CSR objective: the achievement of an energy consumption reduction goal (a 30% reduction of energy consumption from 2008 to 2018).

FOCUS ON ASIA–PACIFIC

As observed for European and North American companies, the integration of CSR considerations within executive remuneration scheme is an area of weakness for Asia-Pacific companies. Only four players out of 250 report to integrate CSR targets as part of the criteria for determining executive remuneration: Stockland, Qantas Airways, AMP Ltd. and Australian Stock Exchange Ltd.

Examples of best practices

- **Stockland** (Financial Services – Real Estate): the company’s executive bonuses are linked to several CSR objectives. The measures used to assess executive performance include: employee turnover, well-being Index scores, and independent surveys of investor perceptions. A minimum performance threshold of 50% of targets, throughout the three scorecard elements must be achieved for any short-term incentive to be payable.

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Conclusion

Corporate Governance is one of the key CSR areas in which a company can take action: it represents the decision making level in which the management’s choices in terms of CSR are taken.

This report shows that CSR integration in the corporate governance system is a subject on which the majority of the companies under review communicate although, in most cases, on a limited scope of subjects. When focusing on the geographical differences, European companies appear to be more advanced than North American ones. This may be explained by advanced codes of Corporate Governance which support a multi-stakeholders approach to the governance in some European countries. At sector level, two factors seem to impact companies’ integration of CSR issues in Corporate Governance Systems: the social and environmental impacts of companies’ operational activity and the legislation they are subject to. Indeed, companies operating in industries (such as Energy, Mining and Metals, Electric & Gas Utilities) having strong and direct environmental and social impacts show on average a higher level of integration of CSR issues in their Governance System.

Companies under review appear to have assimilated the importance to review CSR issues at board level, and the large majority of them have at least validated at Board level the CSR information published. Yet the implementation of a Board level structure in charge of CSR issues remains an exception. The second most systematic practice is the external certification of the CSR reporting. One fourth of the companies under review have had their CSR reporting certified by an external auditor. This preoccupation for the reliability of the CSR information published may suggest a will to anticipate the future legislation which might set more stringent requirements in terms of CSR reporting.

The level of inclusion of CSR considerations within the audit and internal control system appears lower: less than 15% of the companies include CSR risks in the internal control system and have the audit committee supervising CSR risks. Finally, the integration of CSR-related performance criteria into executive remuneration is an exceptional practice, put in place by only 2% of the companies under review. By improving the integration of CSR in the audit and internal control systems and in executive remuneration schemes, companies may enhance their image among stakeholders and strengthen their legal security, in a rapidly evolving legislative context.
Appendix

UNIVERSE OF THE STUDY

The evaluated sample comprises 1,223 companies, whose headquarters are located in Europe, the United States, Canada and the Asia Pacific Region (Australia, Hong Kong, Japan, New Zealand and Singapore). They were assessed by Vigeo between December 2010 and June 2012.

The geographic breakdown of the panel is as follows: 645 companies belonging to the European zone, 328 from North America and 250 from Asia-Pacific.

The average level of information on corporate governance issues disclosed by Asia-Pacific companies appears significantly lower than for European and North American companies.

Consequently, companies of the Asia-Pacific zone have been assessed separately.

This universe is divided into 36 different sectors of varying size. The largest sectors (Banks and Electric & Gas Utilities) comprise 57 corporations each, while the smallest sector (Home construction) consists of five corporations. The most represented country is the United States, with 299 corporations, while only 4 entities are from Luxembourg. Considering the Asia-Pacific region, China (Hong Kong), and New Zealand are represented by only one company each, versus seven for Singapore, while the panel of Japanese companies comprises 169 entities.

In order to maintain a certain level of representativeness within the analysis, sectors comprising less than 15 companies are included in the global panel but are not analysed as part of the sector focus. Six sectors are concerned by this exclusion: Home construction (five companies), Tobacco (seven companies), Forest product and papers (eight companies), Waste and water utilities (eight companies), Beverage and Travel & Tourism (ten companies).
The assessment method

Each company has been assessed on whether CSR considerations have been integrated into the different channels of integration of the corporate governance system. Six questions have therefore been analysed:

- Do trainings provided to board members cover CSR issues?
- Are CSR topics discussed by the Board of Directors, either during the validation of external CSR documents or via the implementation of an independent CSR committee?
- Does the internal control system allow the identification of CSR risk factors?
- Do the audit committee’s responsibilities include the oversight of CSR risks?
- Did the company publish an externally certified CSR reporting?
- Are CSR performance indicators taken into account in the executive remuneration system?

Results obtained were matched to a binary variable (0 for the absence of integration of CSR elements in the analysed aspect; 1 for the integration) and gathered by geographical zone (Europe, North America and Asia-Pacific) and sector of activity. This report presents a global analysis, as well as a comparison of results by zone.
This study

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