

THE QUIET REVOLUTION IN BUSINESS REPORTING

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The Quiet Revolution in Business Reporting

"...the value of reporting goes far beyond transparency. It becomes a tool for improving both our management of business and in giving us clues about what we need to do next."

~ Philip H. Knight, Founder and Chairman of Nike¹

"We would like companies to tell us... what the ultimate risks are. But we'd also like to hear, qualitatively, about what they're doing in terms of board leadership, in terms of the management of the companies and also in terms of the incentives they are providing within their companies, within their communities to do the right thing."

~ Abby Joseph Cohen, Partner and Chief Portfolio Strategist for Goldman Sachs²

A glimpse into the future

The year is 2010. The transformation of business reporting is in full bloom. Institutional investors, financial analysts, company employees, environmental activists, local governments and a host of other stakeholders routinely access company reports that cover in equal measure the organization's financial, environmental, social and governance performance.

With the click of a mouse, comprehensive, comparable, audited information on workplace health and safety, product stewardship, wage scales, board composition and a plethora of other data are available to any party seeking to assess a company's performance, past and future. The arbitrary distinctions between financial and non-financial information, tangibles and intangibles, "hard" and "soft" information have dissolved.

This new model of 21st century business reporting is the result of years of debate, innovation and consensus building that began in the late 1990's. Capital markets, corporations, and the full spectrum of stakeholders are the winners. Comprehensive business disclosure has become the norm and is generally recognized as a core component of good corporate governance, enabling corporate executives and boards to anticipate new challenges, make effective long-term investments, understand the firm's performance relative to industry best practice, and respond to the increased complexity of an interdependent global economy.

The current disclosure deficit

Public disclosure is the lifeblood of the modern global economy. Without credible, timely, audited information, markets cannot function efficiently. Uncertainty fosters volatility, and companies suffer from diminished confidence among investors, communities, civil society and other stakeholders.

In contrast, comprehensive disclosure promises rich rewards: the efficient allocation of capital resources; the channeling of capital to worthy, long-term value-creating companies; and the leveling of sharp swings in market performance. With the exception of those who benefit primarily from speculation and churning, all market players stand to gain by eliminating the disclosure deficit.

How did we get here?

"We all knew that a corporation... was an organism that pulled in resources, transformed them, and emitted products, knowledge, and waste, and that only some of the inputs and outputs were captured by the form of measurement we refer to as accounting. As a result, our idea of what it is to create wealth—real, lasting wealth, genuine, enduring capital—is hopelessly primitive and unsophisticated."

~ Bob Massie, Founding Chair of GRI Steering Committee³

1. Nike, 2004 Corporate Social Responsibility Report.

2. Institutional Investor Summit on Climate Risk, United Nations, May 2005.

3. Global Reporting Initiative (GRI) G3 conference, Amsterdam, October 2006.

"...if material risk assessment in financial reporting were able to reach out ... even three years -- then they will surely encounter climate risk, and it will need to be measured, and it will need to be reported, and the uncertainties associated with it disclosed to the shareholder owners..."

~ Rick Murray, Chief Claims Strategist, Swiss Re⁴

When companies report on their quarterly and yearly performance, they do so using accounting rules that suffer from five key shortcomings:

Backward-looking. Conventional corporate reporting primarily describes what has already occurred—revenues, net earnings and depreciation of assets during a specified time period. From an investor and broader societal perspective, such reporting is inadequate to judge a company. Stakeholders, especially investors, need to know about future prospects, not just past results. Large portions of the financial community, especially private equity and hedge funds, are restlessly searching for—and finding—solid proxies for future performance. These discoveries gradually need to be incorporated into information available to the entire investing community.

Transaction-centric. The underpinning of conventional financial accounting is the transaction. Reading the annual accounts of a company is largely an exercise in the type and magnitude of its transactions—sales of goods and services, payments to suppliers, wages paid to employees. Exceptions exist, such as estimates of “fair value” of an asset yet to be sold. But such exceptions reinforce the rule. The transactions-based foundation, while a necessary component, is insufficient to rigorously assess the performance and prospects of the company. Nor is it sufficient to meet the information needs of stakeholders, who are often more interested in the long-term capacity of firms to maintain and increase value. One can infer only a small amount about the future quality or volume of the water in a lake by reading about how many gallons went over the dam last year.

Missing intangibles. The modern economy increasingly relies on intangible assets to drive value creation. Intellectual property, capacity to innovate, alliances and partnerships, patents and trademarks, systems and structures for supply chain management, reputation and brand, quality of governance—these intangibles represent a growing share of the company's assets and the determinants of future performance. Identification, measurement and disclosure of such assets lag well behind their pivotal role in value creation. Notwithstanding their uneven appearance in the Management Decision and Analysis (MD&A) portion of financial statements, they are by and large absent from conventional company accounts.

Disconnected assets. Traditional accounting and reporting emphasize discrete assets, presenting them as additive rather than interdependent. In the modern economy, it is increasingly the interaction among assets—people, technology, networks—that drives value creation. For example, capacity to innovate depends on investment in human capital plus the quality of alliances; reputation depends on the quality of supply chain management which itself depends on the quality of internal auditing and control systems.

Financial capital bias. Value creation by companies depends on the interplay of various forms of capital—financial capital provided by shareholders and lenders, human capital provided by employees, natural capital (clean air, water, land) provided by the environment, and social capital provided by government. To understand a company's performance is to understand how it acquires, deploys and expands all capital assets. In contrast, conventional company reporting is rooted in a single form of capital, namely, financial capital. There are innumerable recent examples from around the global economy of seemingly impressive financial structures collapsing because they were built on foundations of sand. A more sophisticated understanding of value allows firms to identify otherwise hidden sources of strength or fragility.

During the 75 years since the advent of modern accounting methods, the nature of value creation has evolved from bricks and mortar to knowledge and innovation. Hence, the recent focus of rule-setters has been on correcting a structure that is fundamentally flawed. New issues continually emerge and new rules are written—e.g., accounting for pension

4. Institutional Investor Summit on Climate Risk, United Nations, May 2005.

obligations, derivatives, and stock options. But these piecemeal responses do little to address the structural shortcomings of the accounting system that is the foundation of contemporary corporate reporting practices.

What is the solution?

Inadequacies in disclosure lie at the core of the case for reinventing business reporting. The solution resides not in abandoning financial accounting, but rather pursuing a four-part strategy that incorporates financial accounting but goes well beyond:

New structure. Fostering a comprehensive, complementary structure of non-financial reporting that addresses the shortcomings of conventional accounting.

Institutional strength. Designating a widely respected, capable institution that can mediate competing information, tools and protocols. Similar to the role played by the International Accounting Standards Board (IASB), this body would function as a fair-minded, unbiased referee to support progress toward a generally accepted standard for non-financial reporting.

Enhanced data analysis. Accelerating the development—already well under way—of information intermediaries and rating groups to analyze and disseminate valuation, risk, performance and other studies based on a new regime in which both financial and non-financial information are accorded equal attention.

Integrated system. Merging existing and new reporting structures into an integrated system of financial and non-financial information. This objective can be accomplished over time with the support of advanced technology such as XBRL data “tagging.”

Progress toward these linked goals is more than a matter of minor corrections and arcane debates among accounting professionals. The injurious effects of obsolete reporting take their toll on the well-being of all parties—investors, companies large and small, as well employees, communities and other stakeholders who depend on credible and timely information to support their decision-making.

This is a moment in time for a shift in how we define, measure and report company value, present and future, and for bringing to life a new system commensurate with the needs of corporate executives and boards, investors and other stakeholders.

Is there progress?

“What are we learning from these reports? First, climate change and actions to mitigate the impact of climate change will indeed have an impact on the value of our investments. These reports reinforce that notion.”

-- Denise Nappier, Treasurer, State of Connecticut⁵

Since 1990, Ceres has pioneered the practice of non-financial reporting, beginning with its first standardized environmental reporting framework. Over the course of the 1990's, the practice of environmental reporting evolved from a rarity to a best practice to a common practice among large firms in the US, Europe and Japan. The Ceres framework served as a key benchmark during this evolution and as an inspiration to other frameworks developed by business associations, civil society groups and government.

The last decade has seen a proliferation of efforts, with at least 80 initiatives seeking to correct deficiencies in financial accounting and reporting.⁶ The sheer number of proposed innovations in measuring value and performance speaks to the widespread recognition among all market players—institutional investors, civil society groups, companies, accountants—that the current system falls well short of producing the information users need and deserve.

5. Institutional Investor Summit on Climate Risk, United Nations, May 2005.

6. Value Measurement and Reporting Collaborative, New Paradigm Initiative, *Rediscovering Measurement*, July 2005. <http://npi.valuemeasurement.net/Downloads/Rediscover.pdf>

The following examples, drawn from the scores of initiatives, are meant to illustrate some of the diversity of objectives, stakeholders, approaches and formats that have been created in response to frustrations with conventional systems of measurement and reporting.

Alternative forms of investor research. The Enhanced Analytics Initiative (EAI) is a coalition of institutional investors with nearly \$1 trillion in assets. Members allocate a minimum of five percent of their respective brokerage commission budgets to support research on “extra-financial” issues. [www.enhanced-analytics.com]⁷

Focused efforts to enhance or correct financial accounting and reporting. An example of this approach is the New Paradigm Initiative (NPI). Affiliated with the Value Measurement and Reporting Collaborative of Canada, the NPI seeks to revisit and update conventional accounting in accordance with contemporary value drivers that are largely absent from conventional financial reports. [<http://npi.valuemeasurement.net>]

Single-issue disclosure initiatives. Examples of efforts to create a disclosure standard based on a single issue include the Extractives Industries Transparency Initiative (EITI) and the Climate Disclosure Standards Board (CDSB). EITI is a global, multi-stakeholder organization dedicated to transparency in extractive industry payments and government revenues from natural resources. By strengthening transparency and accountability, EITI expects to contribute to an improved investment climate, poverty reduction, and sustainable development. [www.eitransparency.org]. CDSB is a partnership of organizations working to standardize the reporting of climate change-related information by corporations, thus fostering greater comparability of data as well as streamlined reporting. [www.ceres.org/news/news_item.php?nid=263] The CDSB includes organizations such as the Carbon Disclosure Project (CDP), which is a collaborative of large institutional investors dedicated to the disclosure of greenhouse gas emissions by large global corporations. It maintains a public repository of information on emissions by hundreds of companies. [www.cdproject.net/aboutus.asp]

Looking back through the history of the development of standards—whether in medical terminology, engineering measurements, financial accounting, or other instances in which human beings have reached agreement on how to describe or measure something in common terms—we see that there are two powerful forces always at work. The first is the force of *innovation*, as human intelligence applies itself to creating more and more precise and useful ways of measuring or communicating important information. The second is *standardization*, through which human communities decide, often by consensus, that they will select among the available innovations and agree on a common means of measurement in order to increase the quality of communication among parties. Innovation is a centrifugal force, flinging human knowledge outward into new areas. Standardization is a centripetal force, holding together a common structure of knowledge and language that allows people to exchange ideas and to deepen their understanding.

As we progress beyond the limited knowledge generated by financial accounting rules worked out over the last three centuries, we need to embrace both innovation and standardization, and to recognize that different organizations can encourage different parts of the process. Innovative groups help create new ideas but run the risk of encouraging proliferation that actually diminishes communication. Standardizing groups help select and promulgate best practice, but run the risk of stagnation. True advancement of human knowledge and a deepening of the understanding of organizational value require a dialectic form of interaction between these forces. Rather than claiming that one dimension or the other is more valuable, all parties should be embracing both the need for innovation and the need to reach consensus on best practice.

The proliferation of initiatives is thus reason for both concern and hope. The concern is that dozens of efforts, if they persist indefinitely, may impede progress toward generally accepted approaches to non-financial measurement and reporting. The hope is that the field of non-financials is young and vibrant, and that the currently intense activity is prelude to a time in the not-too-distant future when the spectrum of innovations will converge into a generally accepted framework. Ultimately, such convergence is prerequisite to achieving the comparability and usability of non-financial information that will elevate its standing to a level equivalent to financial information.

7. See also: James O’Loughlin and Raj Thamotheram, *Enhanced Analytics for a New Generation of Investor*, Universities Superannuation Scheme Ltd., May 2006.

The Global Reporting Initiative (GRI): The emerging standard in comprehensive non-financial reporting

“Bank of America recognizes that successful implementation of our environmental policies relies upon transparency to all stakeholders, appropriate training of associates worldwide and regular public corporate reporting according to GRI. The bank is committed to reporting, using the GRI as a guideline...”

~ Bank of America 2005 Sustainability Report⁸

GRI is the leading global multi-stakeholder organization in the field of non-financial reporting. Conceived and founded in 1997 by Ceres, in conjunction with the Tellus Institute, it now operates as an independent organization affiliated with the United Nations.

GRI's *Sustainability Reporting Framework* is emerging as the de facto norm that is providing the platform for integrating disparate initiatives into a coherent, credible and adaptive structure. With close to 1,000 GRI reporters in 60 countries, plus thousands of stakeholders who have contributed to the development of the framework, GRI has become the most widely adopted and recognized system of non-financial business reporting. Through its partnership with the UN and its role as the reporting framework for the UN Global Compact, GRI is in a strong position to actualize the full global potential and reach of its work. [www.globalreporting.org]

Among the various efforts to advance non-financial reporting, the GRI is unique in the following ways:

- GRI is global in scope, designed to achieve a generally accepted, international norm that transcends national and regional idiosyncrasies. GRI disclosure is all encompassing and cross-sectoral, including the full environmental, social and governance (ESG) content, as well as economic (as distinct from financial) indicators. GRI's Sector Supplements, plus the upcoming series of National Annexes, round out the fullness of GRI's approach.
- GRI's governance, working groups, and audience all span multiple stakeholders, including investors, civil society, environmentalists, labor, human rights advocates and, not least, corporations themselves.

GRI's third generation reporting framework (G3) maintains its historic ESG focus while achieving major strides in meeting the special needs of investors, including information on management and strategy, risk and opportunity. In addition, with the G3, the GRI has continued to blaze new trails by developing or further enhancing the following:

- Emphasis on the key role that stakeholders play in the reporting process.
- Reporting Principles that address report content, quality and boundaries. These are accompanied by a set of self-tests that assist in applying the Principles.
- A system for reporting on the full range of economic, environmental and social (labor practices, human rights, society, and product responsibility) aspects of the business. Each aspect includes Disclosure on Management Approach and Performance Indicators. Indicator Protocols accompany each Performance Indicator to assist report preparers and readers with definitions and other technical resources. Even a cursory examination of the G3 (available at www.globalreporting.org/ReportingFramework/G3Online/) reveals the clarity, rigor, and practicality that have emerged for each section and indicator, the result of years of discussion and refinement by hundreds of practitioners and experts.
- A system of Application Levels for declaring the extent to which a report is GRI-based. Report preparers have the option to self-report, use a third-party opinion, and/or request that GRI check the self-declaration.

What is the relationship between GRI and the many other non-financial reporting initiatives? The answer is *synergistic, complementary, and integrative*. Initiatives such as EITI and CDP serve to provide powerful, topic-specific information that can flow into the GRI framework to the benefit of both the initiatives and GRI—and ultimately, report users. Meshing the two promises to accelerate the emergence of non-financial reporting into its rightful place as equivalent to financial reporting.

8. Bank of America, 2005 Sustainability Report.

GRI depends on the continued innovation that will naturally arise as more and more people apply their minds to the problem of measuring new forms of value; as this occurs, the GRI, as both institution and global community, will gradually identify those ideas and inventions that deserve promotion to standard practice among all parties.

The best of futures sees alliances and partnerships, with GRI as steward of an overarching repository capable of harmonizing information generated by a multiplicity of parallel, issue-specific initiatives. For example, the GRI already endorses the use of the WRI–WBCSD Greenhouse Gas Emissions Protocol. At the heart of GRI's mission is the capacity to provide this kind of integration, leading to “one-stop shopping” for report users.

As evidenced by the proliferation of single-issue disclosure initiatives, demand for non-financial reporting continues to expand. The diversity of players contributing to this growth will benefit from a strong consensus-building institution that can move the field forward toward agreement on best practice. Such an institution will have the legitimacy and technical competence to adjudicate content, tools and protocols and thereby bring rigor, consistency and completeness to non-financial reporting in the coming decade.

GRI's organizational and governance structure was designed to manage this kind of complexity and dynamism. It has honed the process of updating the reporting framework through three generations of guidelines, in each case through a broad-based global process of data gathering and consensus seeking among a diversity of stakeholders. True international consensus would be impossible if a single constituency or regional perspective dominates the organization. GRI derives its greatest technical strength and intellectual legitimacy through its broad-based, long-term, and inclusive process.

The institutionalized structure and multi-stakeholder process help to insure that the ongoing work of updating the guidelines proceeds with an eye toward current and future needs of global business, finance, and civil society.

What's next?

“[Sustainability reporting] is not a ‘niche.’ The old way of measuring value is becoming irrelevant to the more complete approach...what we really need to understand and track.”

~ Al Gore, Former Vice-President⁹

Change is accelerating in the field of measurement and reporting of corporate performance. Pressures to bring accounting into the 21st century stem from the demands of market players, including fund managers and trustees, CEOs/CFOs, civil society organizations, consumers and labor groups. Given widespread dissatisfaction and dysfunction arising from the limitations of traditional accounting and the information it produces, the cost of continuing to operate with outmoded structures is high—in terms of risk premiums, market inefficiencies and public distrust. The signal from market players is increasingly loud and clear: it is time to move beyond incremental change in disclosure to more systemic shifts capable of capturing and reporting the true sources of value creation and high performance.

In less than a decade, non-financial concerns such as intellectual capital, brand and reputation, as well as ESG issues such as climate change, working conditions, HIV/AIDS and quality of governance, have moved from obscurity to prominence in assessing the performance and future value of companies. Corporate executives and boards are rapidly acquiring new tools with which to select the best long-term value-creating strategies. The overall trend is irreversible, but as in all system shifts the vital debate will continue about how to balance the centrifugal and centripetal forces at work. Much is at stake in fashioning a concerted, integrated response in order to maintain the right energy, creativity, and equilibrium to move the whole system to deeper knowledge and more efficient practice.

The quiet revolution in business reporting marks a transition in the recognition of how value is created in business and, equally so, how business relates to the society in which it operates. The search for new ways to measure and report is closely coupled with the broader issue of wealth creation, its nature, sources and beneficiaries. The reporting revolution signals that a corporation is accountable not only to its shareholders and for the financial bottom line, but for its environmental, social and governance performance. Although the latter have received negligible attention in traditional accounting structures, their relationship to risk and opportunity is rapidly moving from the margin to the mainstream.

New concepts of value creation, a new reporting architecture, and new institutional arrangements to steward this long-term process define the challenges and opportunities ahead. Even a decade after the conception of GRI, we are still in an early stage in building the field of non-financial business reporting. GRI's demonstrated capability as unbiased broker and adjudicator among stakeholders and across issues bodes well for its continuing leadership role.

9. Global Reporting Initiative (GRI) G3 conference, Amsterdam, October 2006.

About the author

Allen White, Ph.D., is a vice president of Tellus Institute where he directs the Corporate Redesign Program. He has 30 years of experience advising multilaterals, foundations, corporations, and NGOs on strategies and policies for elevating the contribution of corporations to sustainable development. He co-founded the Global Reporting Initiative and served as its director from 1999–2002. In 2004, he co-founded Corporation 2020, an initiative focused on designing future corporations to sustain social purpose. Dr. White has served on advisory boards and committees of ISO, Civic Capital, a social investment fund, the Institute of Responsible Investment at Boston College, and Instituto Ethos (Brazil). He is the chair of the board of directors of GAN-NET, a non-profit dedicated to capacity building and movement building of global action networks that address critical issues of health, education, environment, trade and transparency. He also serves as senior advisor to Business for Social Responsibility. Dr. White has published and spoken widely on corporate responsibility, sustainability, and accountability. Earlier in his career, Dr. White held faculty and research positions at the University of Connecticut, Clark University and Battelle Laboratories, and was a Fulbright Scholar in Peru and Peace Corps volunteer in Nicaragua. Dr. White received a Ph.D. in geography from Ohio State University in 1976.

About Ceres

Ceres is a national network of investors, environmental organizations and other public interest groups working with companies and investors to address sustainability challenges such as global climate change. Ceres also launched and directs the Investor Network on Climate Risk (INCR), a group of more than 50 leading institutional investors with collective assets of over \$4 trillion.

An early leader in the movement toward greater corporate transparency on non-financial information, Ceres conceived and launched (along with the Tellus Institute) the Global Reporting Initiative. The GRI is now an independent organization that is affiliated with the United Nations and provides stewardship for the Sustainability Reporting Framework, the de facto global standard in non-financial business reporting. For more information, visit **www.ceres.org**.

For information about Ceres' work on corporate reporting and governance, contact:

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