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Non-financial reporting

Wood for the trees

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Are company reports on their social and environmental impact any use?

CO-OPERATIVE Financial Services (CFS) is a medium-size banking and insurance business with its roots firmly in the north of England and the 19th century. But in one respect at least it is a 21st century world leader. In a ranking of firms' non-financial reports, CFS came out top, ahead of second-placed Novo Nordisk, a Danish drug company, and BP, the British oil giant. The ranking, published this week, has been prepared by the United Nations Environment Programme and SustainAbility, a consultancy, "in partnership with Standard & Poor's" (S&P), the first time a credit-rating agency has been involved.

Apples and pears
Ranking of 2003 non-financial reports

Rank	Company	Global headquarters
1	Co-operative Financial Services	Britain
2	Novo Nordisk	Denmark
3	BP	Britain
4=	British American Tobacco	Britain
4=	British Telecom	Britain
6	BAA	Britain
7	Rabobank	Netherlands
8=	Rio Tinto	Britain
8=	Royal Dutch/Shell	Netherlands/Britain
10=	Hewlett-Packard	United States
10=	Unilever	Netherlands/Britain

Sources: SustainAbility; Standard & Poor's; UNEP

In their non-financial reports, firms volunteer an overview of their "environmental and social impact" during the previous year. Since the last such ranking, in 2002, many more firms have chosen to produce non-financial reports. At the same time, it is claimed, their quality has increased—as, less happily for the environment, has their length. British American Tobacco's (BAT) runs to some 200 pages.

What was, ten years ago, a quirky, voluntary fringe practice is now becoming mainstream—in Europe, at least. Only two American firms are in the top 20 (HP and Ford), but several of Europe's biggest businesses are there (BP, BT, Royal Dutch/Shell, Unilever). The British government is proposing that big quoted firms be required to publish some form of such accounts annually. It had intended to introduce the requirement next year, but last month was persuaded that businesses need more time to take on board the implications.

The practice started largely in response to pressure from non-governmental organisations (NGOs), which claimed, often contentiously, that many firms lacked social and environmental responsibility.

Yet even as NGOs are becoming more cynical about what firms are producing, some investors now think it is (or could be) a valuable source of information, such as about business risks in a swathe of areas not included on standard financial balance sheets. "We are not social activists; we're independent risk assessors," says George Dallas of S&P. The information in non-financial reports "contributes to building up a company's risk profile." And although it has still not been convincingly demonstrated that good environmental and social practices create value for shareholders, it is clear, says Mr Dallas, that bad ones can destroy it. Exxon's cavalier attitude to the oil spillage from the *Exxon Valdez* drove customers away from its pumps.

Window dressing

The style and content of non-financial reports vary greatly. Some firms spend much time and effort giving out information of uncertain value. Among its targets for this year, for example, CFS aims to maintain its CO_2 emissions from energy use at less than 0.7kg per customer account—a curiously meaningless statistical correlation.

Others undermine their publication's credibility by saying one thing and doing another. BAT, for example, says, "We believe that relevant and meaningful information about our products should continue to be available." Yet the firm makes it very difficult to gain access to the 6m-7m pages of documents about its marketing that litigation by the state of Minnesota forced it to put on the public record.

Currently these can be viewed—by appointment only—at a depository in Guildford, a town some 30 miles south of London. At the end of October, a five-year effort to get around this obstruction, led by the London School of Hygiene & Tropical Medicine, the University of California and the Mayo Clinic, ended with the launch of an independent website (www.bat.library.ucsf.edu) where about 1m pages of documents can be viewed.

The only tool standardising non-financial reports is the Global Reporting Initiative (GRI), a broadly supported checklist of dozens of questions to which almost all of the best reporting firms pay lip service. Rob Lake, head of socially responsible investment engagement and corporate governance at Henderson Global Investors, says "the GRI framework is a good one". But firms can (and do) choose carefully which of its questions they answer.

One which particularly interests investors such as Mr Lake is the GRI's request for a geographical breakdown of taxes paid. (Whether most shareholders really want this made public, given the hostile publicity that low bills might attract, is debatable.) Yet only Anglo-American attempts to provide such a breakdown. BAT, which goes through the GRI list methodically, bluntly states its tax data "are not reported by country", and leaves it at that. Yet it is happy to report how many cubic metres of water it uses for every million cigarettes it makes (7.84, if you're interested).

The only audit performed on these reports is an "assurance statement". Many of these are written by the army of consulting firms that has arisen in response to this new business opportunity. CFS uses four different such firms to "provide audit and commentary" on its 2003 report.

The big accounting firms are now developing this side of their business. BP's assurance statement is prepared by Ernst & Young, the auditor of its financial accounts. Despite the suspicion that Ernst & Young might not wish to antagonise such a big audit client, its report is in places critical. "We consider that BP could have covered the following subject areas in more depth," it says, listing among other things the adequacy of its pension provision for employees, and legal challenges over its $3 billion pipeline from Baku on the Caspian Sea to the Mediterranean port of Ceyhan.

The art of non-financial reporting is evolving and "evolution is always messy", says John Elkington, the chairman of SustainAbility. Firms have been free to disclose only what they wished. But if investors follow S&P in recognising "the importance of non-financial disclosure in the overall assessment of a company's risk profile", that may not be good enough.

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Non-financial reporting

Corporate storytelling

Non-financial accounting is now too serious to be left to amateurs

THERE was a time when companies' social and environmental reporting was not taken seriously. The efforts of pioneers were often dismissed as cynical exercises in public relations designed to appease non-governmental organisations (NGOs). In the 1990s, NGOs increasingly criticised large corporations for their uncaring attitude towards the environment and employees in developing countries. Firms hoped that a few carefully turned words about their employment practices and CO2 emissions might serve to divert the NGOs' wrath.

This not very attractive duckling now holds out the promise of turning into a surprisingly handsome swan. "Non-financial reporting" has moved on from those early days. The British government wants to make it compulsory for large quoted companies. And this week a new ranking of non-financial reports in a joint effort by SustainAbility, a consultancy, the United Nations Environment Programme and Standard & Poor's, the top credit-rating agency, shows how sophisticated they can be (see page 68). BP's 50-page fact-filled document has an introduction by its chief executive, Lord Browne, in which he says that the company's intention is "to report on more than just our financial performance and tell a broader story as clearly as we can".

Story-telling is all very well, but unless it is relevant to a company's performance it is best left to fiction writers. There is growing evidence, however, that the stories which companies are now telling in these reports are of interest to a widening audience, and that they do have a real bearing on a firm's ability to raise capital and recruit the best employees. This year's listing, significantly, was the first to be supported by Standard & Poor's, which says that it now recognises "the growing importance of non-financial disclosure in the overall assessment of a company's risk profile".

The big problem is that the genre's development so far has been haphazard. No one powerful organisation has taken responsibility for its progress. This week's winning reports are as notable for their differences as for their similarities. There is little agreement among the followers of best practice as to what best practice should be. That makes it difficult to compare performance on environmental and social issues across industries or across time. There have been demands for harmonisation, but the most widely accepted attempt to satisfy this demand, the Global Reporting Initiative (GRI), demonstrates the drawbacks of trying to impose the sort of one-size-fits-all format that is appropriate for financial reporting.

To cover the very different social and environmental impacts of companies such as Rabobank and Rio Tinto, a mining ▸▸

▸ firm, the GRI consists of a long list of requests for information which companies can choose to answer as they wish. BP, for example, declines to provide the requested geographical breakdown of the government subsidies that it receives.

In need of a lead

For non-financial reporting to become more of a swan and less of an ugly duckling, more discipline needs to be brought to bear on its standards. For a start, non-financial reports should stick to measurable things. There is still too much waffle about good intentions in even the best reports. Just because such reports are non-financial does not mean that their message cannot be conveyed in figures. And they need to stick to things that are material to the company's business. The report of British American Tobacco would have more credibility if it addressed more of the issues around smoking and health, whereas Co-operative Financial Services' discussion of animal rights and its CO2 emissions seems irrelevant.

There are plenty of things material to almost all businesses that are still not being reported in financial accounts. One is intellectual property. Few businesses try to value it—less than two out of five, according to a recent survey of European companies—and even fewer report it when they do. Another is human resources, which so many companies profess to be their "most valuable asset". Yet few of them say how much they invest in training, or how many employees they lose in a year.

Finally, establishing credibility for non-financial reports is crucial if companies are genuine in their desire to tell a broader story as clearly as they can. And that means not just boasting, but submitting to some form of reliable audit. Accounting firms have been slow to move into this area, but the president of the Institute of Chartered Accountants in England and Wales said recently that he thinks the profession should now take a lead. It is an area sorely in need of leadership. ■