

Non-Financial Information for Valuing Business Sustainability: An Accounting Perspective

Knowledge Forum on Valuing Business Sustainability

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Non-Financial Information for Valuing Business Sustainability: An Accounting Perspective

OUTLINE

- 1. A word about terminology and value concepts**
- 2. Financial information – nature & limitations**
- 3. Non-financial information – types & purposes**
- 4. The Global Reporting Initiative and its Guidelines**
- 5. Management's Discussion and Analysis**
- 6. Quest for the Holy Grail - Future directions**

Non-Financial Information for Valuing Business Sustainability: An Accounting Perspective

Quotation:

"Accountants have long been involved in the processes of measurement and in the presentation and interpretation of data. Over the centuries they have developed increasingly well-structured and meaningful methods for recording, processing and communicating both financial and non-financial information..."

Every business action, if traced with sufficient care, will be found to have both economic and social consequences... employment, the environment, resources, suppliers, products and customers, and the community."

Questions:

1. **What is the source of those statements?**
2. **In what year were they published?**

Answers:

1. **"The Measurement of Corporate Social Performance", American Institute of Certified Public Accountants**
2. **1977**

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OUTLINE

1. A word about terminology and value concepts

- **“Business sustainability”**
- **“Valuing” & “Value” (v. “measuring performance”)**
- **“Non-financial information”**
- **“Accounting Perspective”**

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“Business sustainability”:

Describes the progress (and degree of success) of a business enterprise towards the state where it creates reasonable value for those who have invested in it while respecting the fundamental (Brundtland) principle of sustainable development, and accordingly carries on business in balance with:

- **the imperative to ensure environmental (planetary & ecological) sustainability for future generations;**
- **respect for present and future human needs, societal well-being and social justice, locally, nationally & globally; and**
- **contributing to economic development for the broader public good, locally, nationally and globally.**

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"Valuing" & "Value" (v. measuring or describing performance):

This is about considering and assessing the present and future worth (including desirability & usefulness) of an enterprise in terms relevant to the perspectives and expectations of different stakeholder groups.

What is most relevant to the value concept of current or potential shareholders (or business acquirors) is not necessarily the same as what is relevant to value in the eyes of employees, local communities, suppliers & lenders, etc. (though there may be overlaps, i.e. points of shared interest).

Measuring and reporting different aspects of an enterprise's past and current performance may throw some light upon its "value", but other factors must obviously be considered in a reasonable ("fair"??!) assessment of value, in terms that best measure and communicate relevant insights about such factors.

For example, current or potential shareholders or business acquirors may be very interested in assessing key intangibles, such as the strength of an enterprise's relationships with key stakeholders.

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“Non-financial information”:

This is simply shorthand for “information that is not provided in financial statements and notes thereto, as prepared and presented under Generally Accepted Accounting Principles (or similar standards, e.g. IFRS)”.

It (NFI) can therefore include any other types of information, in both narrative and quantitative terms; if quantitative, NFI may be expressed in monetary or other units of measurement, such as physical and operational, or in ratios and combinations of measures (such as those for eco-efficiency and intensity).

In some cases, NFI metrics may be derived from or related to information reported in financial statements, such as revenue earned per employee, or earnings before interest, taxes, depreciation and amortization, or training costs per employee.

Different classes of stakeholders have different interests in and needs for non-financial information –what’s relevant and material to the decision making of one class is not necessarily relevant and material to another.

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“Accounting Perspective”:

There is more than one accounting perspective. There is the perspective of management accounting, to provide financial and operating information useful to internal decision making about matters such as capital resource allocation, product costs and prices, budgetary control and employee performance evaluation.

There is the historical perspective of measuring and reporting on stewardship of invested financial resources for accountability to investors, to enable them to make informed assessments about the past performance of management and the board. This is the traditional purpose & realm of financial statements.

There is an emerging, future-oriented perspective of reporting to (a) investors and potential investors and (b) other stakeholders, not only about past performance and wealth creation, but also about future performance and value creation prospects. This aims to enable investors, potential investors and other stakeholders to make better informed assessments and decisions about the extent to which their respective expectations are likely to be satisfied in the future.

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2. Financial information – nature & limitations

- **Narrow spectrum of information**
- **Transaction centric**
- **Based on ownership and title to goods & assets**
- **Free use of commons is ignored – not “full cost” based!**
- **Excludes unpriced environmental & social externalities – not “full cost” based!**
- **Ignores key intangibles that create value
(i.e. employees, customers, key stakeholder relations, intellectual capital, brand & reputation, etc. are not explicitly on the balance sheet)**
- **Does not account for differences between market cap of company’s traded shares and value of company portrayed in financial statements**

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3. Non-financial information types & purposes:

Valuing business sustainability calls for

1. A general assessment of the extent to which **environmental, economic, social and governance** factors are integrated into business strategy, risk management and key performance measures used by management for decision making and monitoring performance.

This necessitates disclosure (NFI) about **business strategy, risk and risk management, key performance drivers (especially “intangibles”) and key performance measures (financial and non-financial)** used by management for decision making and monitoring performance, and the extent to which the company has integrated **sustainability factors** into management decision making and performance measurement; together with

2. Reliable NFI about these **sustainability factors** and how they affect or may affect “business sustainability”.

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3. NFI for valuing “business sustainability” therefore comprises disclosures about matters such as:

- ✓ **Environmental/natural capital** – various aspects of how the enterprise affects ecological sustainability (and vice versa)
- ✓ **Intellectual capital (as well as property)** – innovation, R&D, patents applied for, etc.
- ✓ **Customer relationships** – loyalty, complaints, markets & market share, brand value, etc.
- ✓ **Human & social capital** – employees and workplace, community relations, human rights, etc.
- ✓ **Supplier and supply chains** - relationships, policies, practices etc.
- ✓ **Government and regulatory relations** – license to operate, access to resources, etc.
- ✓ **Economic impacts (local, national)** - jobs, taxes, subsidies, purchase of supplies & services, offshore outsourcing, credit and payment practices, community investment, anti-competitive practices, etc.
- ✓ **Structural/organizational capital** – vision, board & governance practices, values & ethics, codes of business conduct, anti-corruption policies, quality of management team, management philosophy, executive compensation, internal control, management policies & systems, etc.

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3. NFI relevant to valuing business sustainability – some thoughts about who might use it, and why:

- **Is there any evidence that investors want to value a business through a sustainability lens? If so, what is the evidence and what does it say?**
- **Would a smart investor's assessment of business sustainability ignore any types of NFI? Weigh some types more than others? NB "Materiality"!**
- **Do companies know what NFI their investors really want? Is there any business benefit in addressing & responding to investors' needs?**
- **Do all other stakeholders generally want all the same types of NFI? If not, then who typically wants what? NB "Materiality"!**
- **Do companies know what information their particular stakeholders want, and why? What if they don't know? Should they provide NFI anyway, and if so, exactly what?**

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4. The Global Reporting Initiative and its Guidelines

Background – present sources of reported NFI include:

Mandatory

- **Management's Discussion & Analysis - MD&A (securities regulators)**
- **Annual Information Form (securities regulators)**
- **Corporate Governance Disclosures (securities regulators)**
- **National Pollutant Release Inventory (TRI in USA)**
- **GHG emissions reporting (Alberta and federal)**

Voluntary

- **Annual reports (outside the financial statements and MD&A)**
- **Carbon Disclosure Project questionnaire (GHG emissions etc.)**
- **Questionnaires from rating agencies, DJSGI, SRI research, NGOs etc.**
- **Sustainability reports (a.k.a. Corporate Social Responsibility, Public Accountability, etc.)**

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4. The Global Reporting Initiative and its Guidelines

Fact: The GRI Guidelines are becoming de facto the world standard for organizations to prepare and present NF information in “sustainability reports”.

Fact: The GRI Guidelines were developed to address the “transparency imperative” in response to the collective interests of a diverse range of stakeholders regarding an organization’s economic, environmental and social impacts.

Fact: The GRI Guidelines aim to provide a trusted and credible globally shared framework of concepts, principles, consistent language, and standardized metrics for reporting about the global sustainability of an organization’s activities.

Fact: The GRI Guidelines have been developed since 1997 by the collaborative efforts of a network of experts from a wide range of stakeholder classes, including business, labour, NGOs, investors, accountancy and others.

Question: Do sustainability reports designed for “transparency” purposes per the GRI Guidelines provide all that is needed for (a) investors, (b) others, to value business sustainability?

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4. The Global Reporting Initiative and its Guidelines – evolution:

- **GRI commenced in 1997 by CERES & UNEP**
- **GRI Sustainability Reporting Guidelines – pilot, 1999**
- **GRI SR Guidelines – 1st. Edition, 2000**
- **GRI SR Guidelines – 2nd. Edition, 2002**
- **GRI SR Guidelines – 3rd. edition (“G3”), 2006, plus indicator protocols and sector supplements**
(www.globalreporting.org)
- **Other GRI tools & services**
(NB. www.CorporateRegister.com/gri)

Sustainability Reporting Trends

The rising number of reporters in Canada

	Overall	Ref. GRI
2001:	57	4
2002:	79	N/A
2003:	100	25
2005:	114	40
2007:	? (guess: >120)	? (guess: >40)

Source: Stratos Inc. Gaining Momentum (2005) & Building Confidence (2003)

Sustainability Reporting Trends

Reporting by sector in Canada - number of reporters

	2005 (n= 102)	2001 (n=56)
Financial	21	4
Mining	16	7
Forest products	13	8
Utilities	12	13
Oil & Gas	10	7
Manufacturing	10	3
Chemicals	6	7
IT/Telecom	5	4
Transport	5	0
Pipelines	4	3

Source: Stratos Inc. Gaining Momentum (2005) & Building Confidence (2003)

G3 Reporting Principles

(adapted from principles underlying accounting standards and financial statements)

Content

- Materiality
- Stakeholder Inclusiveness
- Sustainability Context
- Completeness (+ see Boundary below)

Boundary

- What's in, what's not

Quality

- Balance
- Comparability
- Accuracy
- Timeliness
- Clarity
- Reliability

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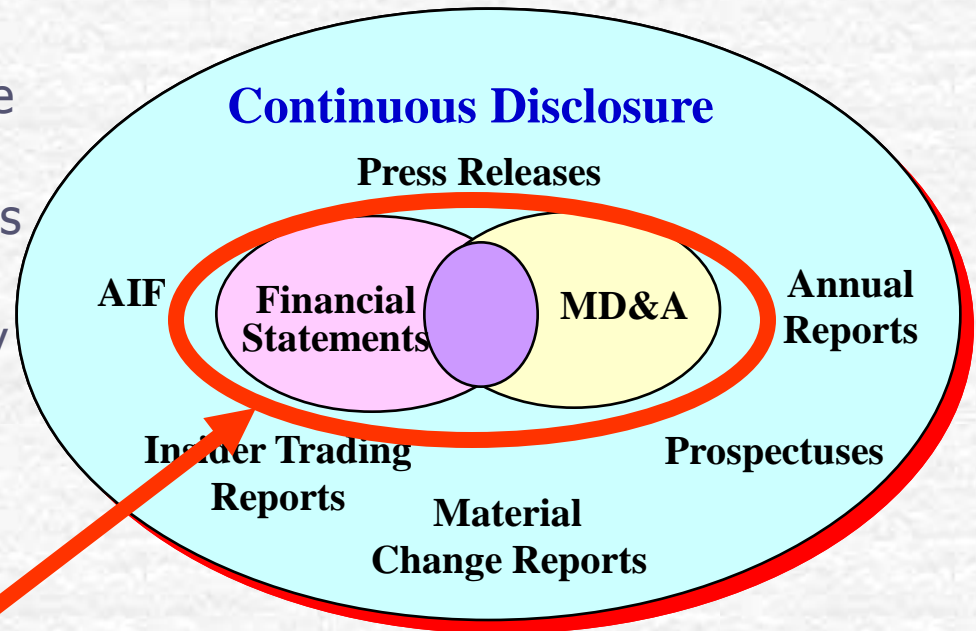
4. The Global Reporting Initiative and its Guidelines – some challenges and questions:

- **Should “transparency” based GRI guidelines aim to address full spectrum of NFI needed for **valuing** business sustainability? What is missing or inadequate?**
- **How to provide all the NFI meaningful, relevant and material to wide range of stakeholders, without report overload?**
- **How are organizations to deal with issues of reliability and credibility of information that is reported by management in order to secure stakeholder trust? Is independent assurance or verification needed?**
- **Is it important to better integrate sustainability NFI with traditional financial reporting? How to make more useful to investors, analysts etc.? (NB. standardization/comparability; XBRL)**
- **Are GRI’s Guidelines complete and robust enough to be mandatory? Should they be mandatory?**

Management's Discussion & Analysis – NFI for Investors!

"The MD&A report should communicate information that helps users understand and assess past performance and future prospects" (CICA)

- The MD&A and F/S together form the foundation for "business reporting"
- MD&A supplements and complements F/S
- MD&A and F/S **together** must "fairly present"...
- MD&As now subject to audit committee and board approval in all Canadian securities jurisdictions



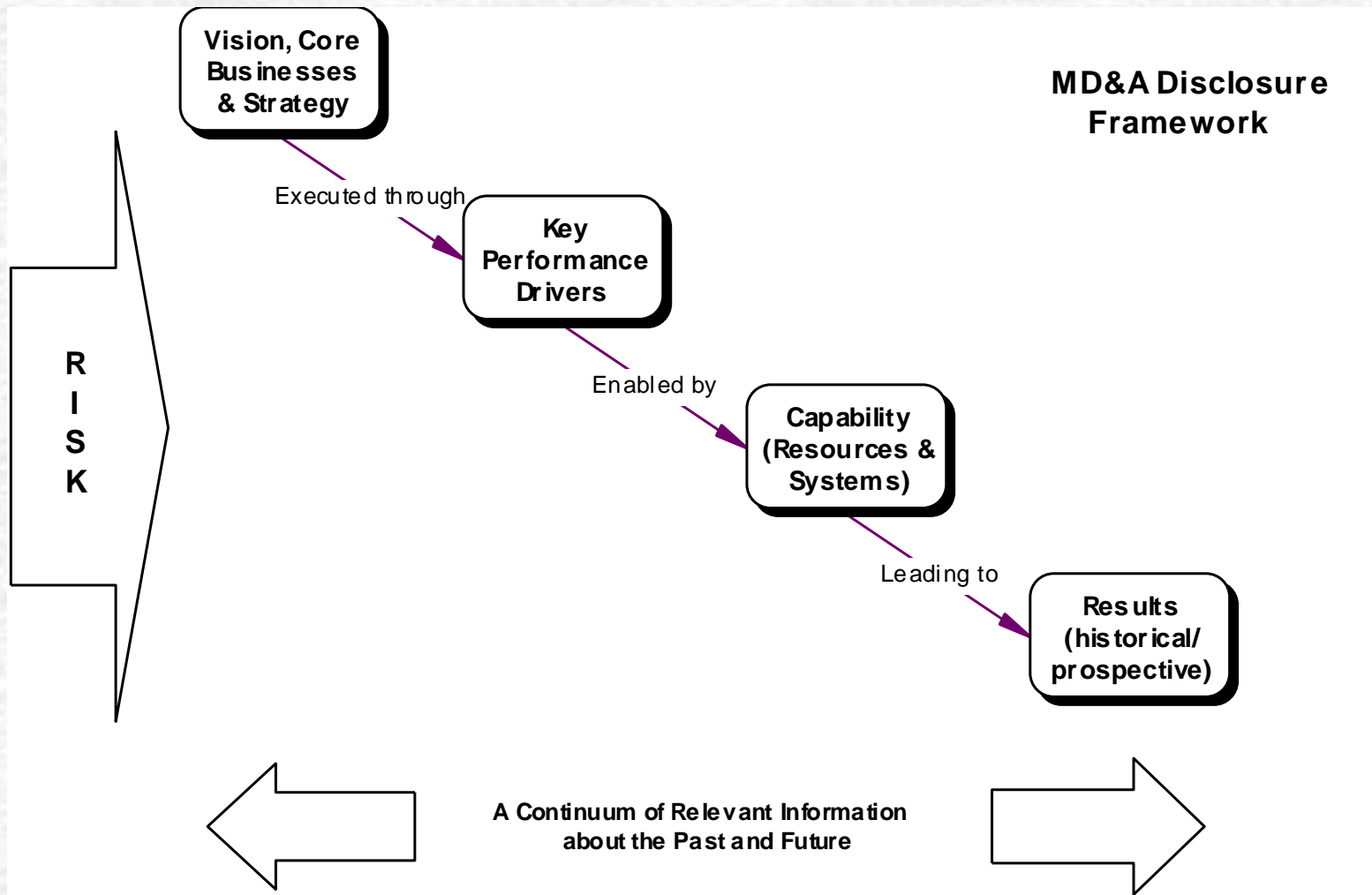
**Core Business
Reporting Package**

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5. Management's Discussion and Analysis

- Required by securities regulators, to accompany financial statements
- Provides narrative explanations "through the eyes of management"
- To help current and prospective **investors**:
 - understand what the financial statements do and do not show
 - discuss material information that may not be fully reflected in the financial statements
 - discuss important trends and risks that have affected the financial statements ... and are reasonably likely to affect them in the future
- Must discuss important trends, events, uncertainties and risks that are reasonably likely to have an effect on your company's business
- Also (AIF): financial & operational effects of environmental protection requirements; environmental and social policies fundamental to operations and steps taken to implement them; risk factors ...likely to influence **investor** decision making;
- Investors seeking use of MD&A for disclosures about climate change issues that impact or are likely to impact the company's business and financial performance

CICA Framework for MD&A, 2004 (Climate Change supplement in progress)



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6. Quest for the Holy Grail – NFI Drivers & Enablers

Drivers of demand for better NFI for valuing business sustainability include:

- **UN Principles for Responsible Investment**
- **UN Global Compact**
- **UNEP Finance Initiative Asset Management Working Group**
- **SRI organizations & investors**
- **International Corporate Governance Network (institutional investors)**
- **Governments (Sweden, France, EU) & securities regulators**
- **CFA curriculum and future CFAs**
- **Investment research houses & rating organizations**
- **Governments and Stock Exchanges (e.g. Sweden, France, EU, J'berg)**
- **And eventually all mainstream investors and analysts!**

Also:

- **Carbon Disclosure Project**
- **Investor Network on Climate Risk**

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6. Quest for the Holy Grail – NFI Drivers & Enablers

Enablers for providing better NF Information for valuing business sustainability include:

- **Global Reporting Initiative and its Sustainability Reporting Guidelines**
- **Academia (as as educators as well as researchers)**
- **Industry associations**
- **Governments (e.g. federal website on SR, UK DEFRA)**
- **Prince of Wales Accounting for Sustainability Project, 2007?**

Plus increasingly (we hope!):

- **Accounting bodies (international, domestic – IASB, IFAC, CICA, ICAEW)**
- **Accounting firms (as performance measurement & business reporting advisors)**

And above all, accounting professionals in companies whose boards and management are committed to enhancing, measuring progress towards and demonstrating the value of business sustainability.

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6. Quest for the Holy Grail – Concluding thoughts:

At the end of the day, how realistic is it to expect to devise any one approach or algorithm for valuing business sustainability, or is it enough to provide the NFI that enables individual investors and stakeholders to make their own assessments of business sustainability?

An accounting perspective, with accompanying skills and tools, is necessary but alone not sufficient to achieve the Holy Grail of valuing (and progressing towards) business sustainability, and devising the necessary NFI.

Multiple perspectives, systems thinking, new measures of success and continuous improvement in devising and reporting NFI are essential for progress towards and valuing (or enabling valuation of) business sustainability.

Better NFI and external reporting practices will evolve over time, in response to stakeholders' demands about business sustainability, enlightened company leadership and new concepts about the value of business sustainability.

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THANK YOU!

Any Questions?

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Some further reading

"Green" Accounting & Performance Measurement Practices & Tools

Accounting for the Environment; Gray, Bebbington, Walters; PCP/ACCA, 1993
Socially Responsible Accounting; Mathews, Chapman & Hall, 1993
Green Ledgers: Case Studies in Corporate Environmental Accounting; Ditz, Ranganathan, Banks; WRI, 1995
Corporate Environmental Accounting; Schaltegger et al; Wiley, 1996
Full Cost Accounting from an Environmental Perspective; CICA, 1997
The Green Bottom Line; ed. Bennet & James; Greenleaf Publishing, 1998
Accounting for a Clean Green Environment; Gilkison; KPMG, 1999
Sustainable Measures; ed. Bennett & James; Greenleaf Publishing, 1999
Counting What Counts; Epstein & Burchard; Perseus, 2000

NF Information for Sustainability Measurement & Valuation

The Measurement of Corporate Social Performance; AICPA, 1977
Environmental Performance: Measuring & Managing What Matters; Willis & Desjardins; CICA, 2001
The Sustainability Advantage; Willard; New Society Publishers, 2002
Stakeholder Relationships, Social Capital and Business Value Creation; CICA, 2003
Financial Reporting Disclosures about Social, Environmental & Ethical Issues; CICA, 2004
Guidance on Corporate Responsibility Indicators in Annual Reports (draft), UNCTAD/IWGE on ISAR, 2006
Added value, long term – NF KPIs in Annual Reports of German Companies; Hesse; Deloitte, 2006
Enhanced Analytics for a New Generation of Investor - How the Investment Industry Can Use Extra-Financial Factors in Investing; O'Loughlin & Thamotheram; USS (UK), 2006
Show Me The Money: Linking Environmental, Social & Governance Issues to Company Value; UNEP FI Asset Management WG , 2006
Sustainability Reporting Guidelines; Global Reporting Initiative, 2006
Einstein in the Boardroom – Moving beyond Intellectual Capital to I-Stuff; Harrison & Sullivan; Wiley, 2006
Sustained added value – Investor & analyst demand for sector-specific sustainable development KPIs in Management Commentaries of German companies; Hesse; Deloitte, 2007
Responsible Investment in Focus: How leading pension funds are meeting the challenge; UNEP FI Asset Management WG & UK Social Investment Forum, 2007
Capital Markets & Sustainability - Investing in a Sustainable Future; NRTEE, 2007
Demystifying Responsible Investment Performance; UNEP FI Asset Management WG & Mercer, 2007;
Making Sustainability Work; Epstein; Greenleaf Publishing & Berrett-Koehler, 2008