tomorrow's company

CIMA

Chartered Institute of Management Accountants

Tomorrow's balance sheet

Integrating strategies for corporate responsibility and evaluating their impact, both socially and environmentally, is becoming increasingly critical to business. Companies are seeking ways to successfully put their strategies on sustainability into practice - strengthening the connection between corporate responsibility and global competitiveness.

This paper summarises the key discussion points from a high level roundtable discussion organised by CIMA and Tomorrow's Company, where senior business decision makers met with experts in sustainability.

Discussion paper February 2011

Conclusions

1. There is little convergence between methods used by companies, even within similar sectors, in relation to sustainability and wider non-financial reporting. Benchmarking becomes more problematic and challenging. The International Integrated Reporting Committee (IIRC see box 1) encourages convergence.

2. It is not clear how reporting on corporate social responsibility is used, how much is 'left out', and what information is of value to investors or the wider society. Integrated reporting would present a more complete picture of an organisation's performance and the factors that will influence its long-term success.

3. Companies may be motivated by either commitment to the agenda or compliance. Commitment may ensure the integration of CSR strategies, but compliance is needed to push integration forward.

4. There is an increased need to provide hard evidence of the positive impact on society, the environment and the strategic returns for the business and how any negative effects are being addressed.

5. High quality management information on social, environmental and ethical performance is vital for monitoring a company's social and environmental impact and for compiling integrated reports, but such information may not be explicit. There will be an increase in the use of tacit information, and in decision making made without hard facts and figures, but with other qualitative data.

6. New mindsets and ways of working internally and externally will need to be promoted and developed. Co-creation will need the input of employees and wider stakeholders: customers and society.

7. Companies that are already leading and pay more than lip-service in this arena will continue to be at the vanguard and have valuable lessons to share. The imperative is to bring others to the table and to enable engagement.

8. Governments globally, and collectively, have a role to play, through regulation and dialogue to encourage companies to bring benefits to the wider economy and society, as opposed to pursuing short-term gains.

Recommendations

1. Sustainability issues must be embedded in business models, organisational strategy and decision making processes so they can be captured and reported on.

2. Senior managers and business leaders must increase their understanding of the demands and issues, and share learning with the wider sector and engage with stakeholders. New skills and tools are needed.

3. Non-executive directors should act as custodians of sustainability, with the particular duty of ensuring that their executive colleagues are building a sustainable business.

4. External reporting should be a by-product of the business. Internal information gathering needs to avoid costly role duplication or unnecessary data capture. Management accountants can help avoid the dilution of information and ensure global decision makers adopt a longer-term approach to the creation of value.

5. Management accountants are encouraged to help ensure that businesses measure performance to an appropriate timescale to assist in the delivery of sustained and sustainable success, and to define and adopt new ways of enabling this.

6. Finance professionals are encouraged to engage directly with developments in integrated reporting with key stakeholders internally and externally, and develop relevant skills, knowledge and tools.

7. Businesses should create a dialogue with government and civil society.

About CIMA

CIMA, the Chartered Institute of Management Accountants, founded in 1919, is the world's leading and largest professional body of management accountants. With more than 183,000 members and students operating in 168 countries, CIMA works at the heart of business, in industry, commerce, public sector and other not-for-profit organisations. Partnering directly with employers, CIMA sponsors leading-edge research, constantly updating its qualification, professional experience requirements and continuing professional development to ensure that it remains the employers' choice when recruiting financially trained business leaders.

CIMA is committed to upholding the highest ethical and professional standards of members and students and to maintaining public confidence in management accountancy. CIMA believes that sustainability is a key issue for all organisations across the world and is committed to supporting its members and students in addressing this challenge. For more information, please see **www.cimaglobal.com/ethics** and **www.cimaglobal.com/sustainability**

For more information about CIMA, please visit **www.cimaglobal.com**

About Tomorrow's Company

Tomorrow's Company is the agenda setting 'think and do' tank which looks at the role of business and how to achieve enduring business success. We focus on strong relationships, and clear purpose and values as the foundation of effective leadership and governance. We believe that busness can and must be a 'force for good'. This requires a strengthening of stewardship by shareholders in partnership with boards of companies. We argue that the Age of Sustainability has begun, and that in the future success and value creation will come from recognising the triple context –the links between economic, social and environmental sub-systems on which we all depend, and the opportunities this brings.

www.tomorrowscompany.com and **www.forceforgood.com**

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Neither these organisations nor the individuals representing them are responsible for the contents of this paper.

Contents

This paper distils the key discussion points from a high level roundtable discussion – **Integrating and measuring sustainable business strategies: tomorrow's balance sheet** – where senior business decision makers met with experts in sustainability.

Anant Nadkarni, Vice President, Group Corporate Sustainability, Tata Council for Community Initiatives (TCCI) presented the Tata Index to the group. Together they discussed how organisations should approach integrating non-financial reporting and the assessment of organisational impact. Conclusions and recommendations are provided on how companies should start to respond, on the basis that sustainability issues are now a strategic imperative.

This round table was part of the CIMA and Tomorrow's Company's 'Tomorrow's Value series' see: **www.tomorrowsvaluelectures.com**

Context

'We look upon the economy as operating to 'natural' laws but, as Ralph Waldo Emerson put it so powerfully, the economy is socially created by us as human beings. How should we price our ethics and behaviours, given the enormous cost of not having done so, that is evident from boardroom failure.' **www.tomorrowsvaluelectures.com**

Mervyn King, the architect of corporate governance development in South Africa and widely regarded as a world authority in this field, believes the financial crisis has created a momentum away from compliance based systems towards more value creating ones, with a performance focus based on principles. Business, however, is still using a 150 year old model that assumes nature has unlimited resources and that waste can be absorbed. The new economy we are entering is **business as unusual** and making **more with less**. Today, governance, strategy and sustainability are inseparable.

Companies need long-term sustainable strategies that they can demonstrate to their stakeholders. Recent Accenture/UNGC research[1] finds that business can do well by doing good, but not until basic sustainability practices are fully integrated into the way business is done, both strategically and operationally. Amongst the challenges business leaders face are the lack of professional capabilities to fully understand, manage and assess corporate value, not least because current metrics are elusive in assessing the return on long-term investment in sustainability.

The positive and negative impact a business has on society is becoming as important as traditional performance metrics. Why? Studies are showing an authentic commitment to sustainability enhances financial performance in the long-term, both through savings, risk mitigation and adding value. The most commonly used accounting practices cannot easily reflect this value, neither fully helping companies to capture it, or track its presence or loss. As a result, the value sustainability brings to a business is not necessarily picked up by current accounting practices.

Over the past decade or so there have been many advances in metrics and reporting methodologies, primarily in the area of corporate responsibility reporting, and particularly in the area of carbon management. However, this is not satisfactorily embedded in the business or the main accounts. In 2010 the IIRC was formed with a remit to create a globally accepted framework of accounting for sustainability, a framework that brings together financial, environmental, social and governance information in a clear concise, consistent and comparable format (See box 1). The IIRC will also be consulting with and influencing the G20 in this regard.

Acting sustainably does not necessarily mean that the drive for profit is abandoned. Directors of successful companies have widened their focus beyond the traditional business driver.

1 Can business do well by doing good? Outlook, Accenture November 2010

Businesses around the world must wake up to the fact that acting in a sustainable manner makes good business sense as this can result in more successful operations that generate reliable cash flows. Society also needs responsible commercial organisations to generate the tax revenue needed to run public bodies, provide employment for its citizens and to produce the goods and services needed to fuel the economy. There are organisations that are already tackling such integration, the Tata group being one. CIMA and Tomorrow's Company believe that with a combination of commitment and compliance, supported by an appropriate operating environment and government intervention, the move towards integrated reporting will accelerate in the coming years.

The Tata Index

Tata, which was founded in 1868 as a trading company in Mumbai, India, has grown into a global corporation with market capitalisation of nearly US$80bn in 2010. Since its inception it has always been aligned to social development, based upon voluntary, as opposed to obligatory, commitment.

Profit is important, because we are a business, but profit is just a means. Communities are the very purpose of the existence of enterprise.

Tata Group established the Council for Community Initiatives Committee (TCCI) in 1996 to examine a group level approach to the assessment of the company's external impact in alignment with corporate core values, systems and practices. The Tata Index[2] was created with the United Nations Development Programme in 2003, to provide guidelines for Tata companies looking to fulfil their social responsibilities. It is built around the Tata Business Excellence Model (TBEM), an open ended framework that drives business excellence in Tata companies. The TBEM has an innovative way of understanding everything by consensus using semi-qualitative methodologies that translate into numbers. This methodology is based on convergence, reflecting not just an individual's opinion but the collective opinions of both internal stakeholders as well as external partners.

At Tata, value is seen as an opinion and assessing it is based upon the leverage of collective wisdom. Its measurement system is ratified by a large number of assessors embedded across the group, which in turn drives universal engagement. Companies on the whole can be very good at processes, evaluating them and their immediate outcomes or results and this can be captured on a balance sheet. However, there is really no way of showing what the impact of an outcome of a particular operation is in the long-term, and that is the challenge that all the reporting initiatives face. This is why the Tata Index has a third dimension of impact. This relates to human wellbeing, and uses semi-qualitative methodologies based on consensus. Tata recognises it is very difficult to move away from objective areas such as number based benchmarks to tacit, ie, more implicit information. Yet it argues that such elements can be brought into figures, not as an end but as a means for further improvement, which feeds back into Tata's development of the business model.

Value co-creation is the domain of aspiration.

Tata also adopts reporting methodologies from the Global Reporting Initiative and ISO 26000 where applicable, and leaders from Tata also have input into the development of such metrics at an international level. However, they recognise that while there are too many reporting methodologies and indicators at present, the convergence of principles is beginning to happen. The IIRC, which Tata is also contributing to, may be able to help move this agenda forward at a global level among the finance community.

2 See **www.tata.com**

Convergence

There is recognition that many different reporting systems and indices are proliferating globally. It is a growing market but without much consolidation, and with a varying focus on different sectors. For example, in the development of ISO 26000, there may have been up to 70 different agencies setting standards with no clear co-ordination. At the same time, with the increase in global mergers and acquisition (M&A) activity in the past decade or so, many separate companies and types of industry with different operating processes, are now part of one huge enterprise. It is a huge challenge, even within one company, to centralise on one particular tool. Even within a particular sector, for example the extractive industry, it is very difficult to compare like with like in relation to corporate reporting.

> *Sustainability in diverse businesses can be the single value driver that runs across all business lines – and is seen as a way to move from growth through acquisition to further growth through increased value for every transaction.*

Today, backward reporting continues to be the focus because that is what shareholders and investors currently require. However, innovative organisations are beginning to use non-financial information to inform strategy and success. Tacit knowledge will increasingly inform decision making and there will be lessons to be learned from the pioneers, which will assist convergence. This convergence, however, is unlikely to be as formal in nature. The more financial reporting is standardised the more complex it becomes and the less it is understood. The current financial crisis is evidence of this.

IIRC is beginning to look at reporting that is meaningful, has an impact and is forward thinking. As a result of the wider remit of moving beyond meeting shareholder requirements, and the increasing demands of civil society, there will be an increasing need to bridge the gap between macro and micro.

> *Companies need to consider how they secure a licence to operate on a continuing basis – how to be a welcome player in society.*

A shift is taking place from relying on benchmarks and indices, to creating further understanding of value drivers and having confidence in business decision making and related business performance in assessing outcomes. There will still be a need for a sectoral core of indicators for companies to report against. What is important in both cases is ensuring a consistency of approach and introducing management systems that support a social and economic 'tool box', connecting key functions across a business, such as human resources, procurement and risk management, in addition to the various operational units.

Management accountants are in the unique position of marrying the financials and dragging sceptics who demand numbers into the world of less formal information. Many will need to be shown new methods to help them understand how to introduce measures into non-financial areas. As 'business as unusual' increases, so too will convergence on new principles of reporting, the rise of identifying and assessing value drivers, and a shared understanding of how this can be done.

Commitment vs Compliance

National and international regulation, together with the growth of a global civil society lobbying and campaigning around business issues, has created an increase in the use of metrics and non-financial reporting. At the same time, there has also been a false confidence in an approach based on benchmarking and indicators to assess outcomes, without a full understanding of true value and practice. It is commonly noted that a lot of best practice is reliant on the commitment of the corporate culture: 'It is part of the fabric of the organisation, you can tell it when you walk through the door, the values are so embedded that the external reporting is a by-product. External reporting becomes an easier part of these organisations' existence because it spills out of what they do anyway.'

Our people, many of whom are shareholders, want to know if, in fact, we are making things better while we are making money. Because if we are making things worse when we are making money they will go and work somewhere else.

Reporting merely to comply with legislation is not what drives leading organisations to operate in the way they do. Many leading companies, in the interest of long-term success, will act 'above the law' in all the different geographical locations they operate in. For these firms it is part of their 'whole' and they are more comfortable when they are not bound by specific metrics and numbers and when they are exploring increasingly qualitative means of assessing performance and impact. They are very aware of the impact, not only on their operating environment, but on their supply chain, enterprise development, health and safety of employees and the wider community. They understand the need to be open about what is working and what isn't, in order to move on and the fact that trust and reputation are critical in underpinning their long-term success. Successful implementation is, in effect, driven by personal beliefs and values and shared culture.

The 'best in class' organisations are already moving beyond what is expected of them, yet the value of regulation, at both national and international level, cannot be underestimated. There is still much to do in bringing others in the market place on board, to raise the game of poor performers, critically those who create negative impacts, with the potential risks for their shareholders, stakeholders and the wider economy, including other companies in the same sector. However, it must be remembered that many companies will be resistant to change unless there is a massive, early, short-term competitive advantage. Creating the environment for that advantage is the goal and governments have a key role in enabling that, within their own markets and collectively through forums such as the G20.

A balance is needed between rigorous rules on the one side and moving towards best-in-class companies and how they report, covering issues that affect government and society as well.

A positive side effect of collecting and using data can be a related change in behaviour within an organisation, galvanising performance in so far as things that were not managed before become better and more consistently managed. Once there is data on trends, the management begins to worry about it and takes action. As a result, in the beginning, even if there is not a high level of external satisfaction, there is a gradual internal improvement in performance. In a whole range of areas of corporate regulation there has generally been a journey from voluntary procedures, to legislation and regulation to normative behaviour. Health and safety, labour standards and financial accounting itself has gone through this process. Regulation helps push the agenda forward.

There is always a risk around regulation. It is undoubtedly helpful in leveling the playing field, and improving corporate conduct, but it can also be unhelpful in that it can be purely a paper disclosure. It is always more informative to know that a company is run well rather than a company has been told to run well. The aggregation of data from large corporations operating across different geographical locations can also dilute understanding: certain information can mean nothing when aggregated globally, whereas at a local level it means everything.

There is a perfect storm brewing: diminishing finite natural resources and capital at the same times as there is huge growth in the world.

Because there has been an increase in reporting, there is subsequently more data to draw on to build a picture about corporate impact beyond just the financial. The value of this is that it takes the learning forward – what is working and what isn't, what is being used and what is supplementary, and, also what isn't being shown and what should be. The key question to ask is 'do we want to understand businesses better or spend a lot of time comparing data.' These are the challenges bodies such as the IIRC will be exploring, to help further the debate and encourage convergence. Comparison and pure compliance should not be the primary plan. Tackling the issue of finding new ways of assessing the corporate community is still at the stage of experimental innovation, with those who are committed leading the way.

Benefit or Cost?

We need to consider what sort of risks our behaviour creates for all those we have an impact on.

When a company invests in infrastructure in a developing economy, perhaps as part of a contract with local government, or to gain access to a site, this can be recorded and reported as an input and investment. But how is the true value shown eg, the creation of local employment, local services and skill development, or alternatively the longer-term negative consequences, perhaps creating bad environmental conditions, or distorting local markets? What on the one hand can be viewed in metrics as an investment can ultimately be a cost. In many organisations there is still a disconnect between a corporate agenda and a societal agenda, locally, regionally or globally. Regulation can help drive the performance of the worst performers towards the best performers, which will benefit the company's position in the long-term.

Summary

It is essential that the corporate reporting system not only allows, but actively promotes, this new corporate philosophy, which is required to drive business forward as it battles to meet 21st century challenges. The longer large numbers of businesses fail to show real commitment, the more likely a straitjacketed approach will be deemed to be necessary, however inappropriate. The actions of commercial organisations are already mistrusted and in many circles the term 'corporate behaviour' has become synonymous with greed, self interest and detachment from the wider world. Nevertheless, there are many companies that have successfully adopted business strategies that recognise wider societal needs yet are still focused on long-term sustainable profitability. Very positively, reporting is evolving. It has to be value driven, has to be embedded in the business, and cannot be driven alone by indicators. Leading companies now are not only asking themselves, how do we deal with wider society, but how do we validate and prove it in practice? Companies need to show that their stories are more than lip-service when a global public is increasingly sceptical and social media are forcing ever more transparency. More and more firms are coming together to understand how best to do it.

Box 1. The Prince's Accounting for Sustainability and International Integrated Reporting Committee (IIRC)

Management information is the linchpin for developing better corporate reporting. Conventional reports and accounts can focus excessively on a company's short-term financial performance. They pass over broader factors, such as the sustainability of the business model or the company's social and environmental impact. In particular, the way that 'nature's capital' is depleted – by the consumption of fossil fuels or the emission of greenhouse gases for example – typically gets ignored. Where companies do disclose such information, it is seldom presented in a way that is connected with the strategic direction and financial performance of the company, clarifies the risks and opportunities or permits year-on-year comparisons.

The Accounting for Sustainability (A4S) initiative, in which CIMA plays an active role, seeks to redress the balance by creating a far reaching connected and integrated reporting model. Chartered Management Accountants are well placed to collate and present this vital data, much of which will be the top slice of routine management information. And their ethical code means that they must present it objectively, whatever the pressures from elsewhere in the organisation to distort unpalatable facts.

In August 2010 the A4S and the Global Reporting Initiative (GRI) launched the **International Integrated Reporting Committee** (IIRC). The initiative has global reach and is a collaboration of established accountancy institutions, standard setters and leaders in corporate governance, business ethics and sustainability. Currently there is no global standard for measuring and reporting on environmental, social and governance performance.

The IIRC has been created to respond to the need for a concise, clear, comprehensive and comparable integrated reporting framework, structured around the organisation's strategic objectives, its governance and business model and integrating both material financial and non-financial information.

The objectives for an integrated reporting framework are to:

- support the information needs of long-term investors, by showing the broader and longer-term consequences of decision making
- reflect the interconnections between environmental, social, governance and financial factors in decisions that affect long-term performance and condition, making clear the link between sustainability and economic value
- provide the necessary framework for environmental and social factors to be taken into account systematically in reporting and decision making
- rebalance performance metrics away from an undue emphasis on short-term financial performance and
- bring reporting closer to the information used by management to run the business on a day-to-day basis.

www.accountingforsustainability.org

www.integratedreporting.org

Box 2. Global Ethics & Sustainability Initiatives:

Global Reporting Initiative (GRI): is a network based organisation that has pioneered the development of the world's most widely used sustainability reporting framework and is committed to its continuous improvement and application worldwide. Sustainability reports based on the GRI framework can be used to benchmark organisational performance with respect to laws, norms, codes, performance standards and voluntary initiatives; demonstrate organisational commitment to sustainable development; and compare organisational performance over time. See: **www.globalreporting.org**

Organisation for Economic Co-operation and Development Guidelines for Multinational Enterprises: First drafted in 1976, these are recommendations addressed by governments to multinational enterprises operating in or from adhering countries. They provide voluntary principles and standards for responsible business conduct in areas such as employment and industrial relations, human rights, the environment, information disclosure, combating bribery, consumer interests, science and technology, competition, and taxation. The guidelines are the most comprehensive instrument in existence today for corporate responsibility multilaterally agreed by governments. See: **www.oecd.org/daf/investment/guidelines**

United Nations Principles for Responsible Investment (PRI): With the growing view among investment professionals that environmental, social and corporate governance (ESG) issues affect the performance of investment portfolios, the PRI provides a framework for investors to assist in these considerations. They are not prescriptive, but instead provide a menu of possible actions for incorporating ESG issues into mainstream investment decision making and ownership practices. The principles came into being in 2006 on the back of a UN initiative and in early 2010 there were 785 signatories. Applying the principles should not only lead to better long-term financial returns but also a closer alignment between the objectives of institutional investors and those of society at large. **www.unpri.org**

United Nations Global Compact: The UN Global Compact is a strategic policy initiative for businesses that are committed to aligning their operations and strategies with ten universally accepted principles, in the areas of human rights, labour, the environment and anti-corruption. By doing so, business, as a primary agent driving globalisation, can help ensure that markets, commerce, technology and finance advance in ways that benefit economies and societies everywhere. In 2010 the UNGC stood as the largest corporate citizenship and sustainability initiative in the world – with more than 7,700 corporate participants and stakeholders from more than 130 countries **www.unglobalcompact.org**

Dow Jones Sustainability Index: Launched in 1999, the Dow Jones Sustainability Indexes are the first global indexes tracking the financial performance of the leading sustainability driven companies worldwide. **www.sustainability-index.com**

CIMA is a member of the UNGC and sits on the supervisory board and various working groups of the International Integrated Reporting Committee.

Related initiative

Tomorrow's corporate reporting

This study by CIMA in partnership with Tomorrow's Company and PwC explores the corporate reporting system and assesses the barriers to and enablers of change. This work offers an insight into the main factors to be considered in order to move towards more effective corporate reporting. For more information see: **www.cimaglobal.com/tcrcfe**

Other relevant CIMA publications

- *Evolution of corporate sustainability practices, CIMA, AICPA & CICA 2010*
- *Incorporating ethics into strategy: developing sustainable business models*, CIMA 2010
- *Sustainability in emerging markets: Lessons from South Africa CIMA 2010*
- *Tomorrow's Value*, CIMA 2010
- *Westpac's Squashed Tomato strategy: sustainability strategy at Westpac*, CIMA & Australian School of Business, Baxter, Chua & Strong, 2010
- *Accounting for climate change* CIMA 2010
- *Managing responsible business* CIMA 2008
- *Climate change: the role of the finance professional (CIMA & Accounting for Sustainability)* 2009
- *Accounting for sustainable development performance (CIMA & Bebbington, J)* 2006

All are available from **www.cimaglobal.com/sustainability**

Also see **www.cimaglobal.com/ethics**

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