The Global Reporters
2004 Survey of Corporate
Sustainability Reporting

Risk & Opportunity
Best Practice in Non-Financial Reporting

STANDARD & POOR'S

SustainAbility

UNEP

Risk & Opportunity is The *Global Reporters* 2004 Survey of Corporate Sustainability Reporting. The *Global Reporters* research programme would not be possible without the financial support of companies dedicated to evolving the accountability and reporting agendas. For the 2004 round, we express our sincere thanks to our major sponsor **Pfizer**, and to the twelve other supporters **ABN Amro**, **Credit Suisse**, **Co-operative Insurance Society**, **The Co-operative Bank**, **the US Environmental Protection Agency's Climate Leaders Program**, **Ford Motor Company**, **Johnson & Johnson**, **Novo Nordisk**, **Rohm and Haas**, **Shell**, **Starbucks Coffee Company** and **Telecom Italia** who ensured the project took wing. Sponsors were updated on progress but did not have any form of editorial control.

Risk & Opportunity considers the question: Is the glass of non-financial (and wider sustainability) reporting currently half full, as enthusiasts might argue, or half empty, as some critics allege? The evidence suggests a positive assessment, though there are still major gaps to be closed in the linked fields of disclosure, reporting and communication.

‘It’s half full’

Several thousand companies, including many of the world’s largest, now report

The leading edge of reporting is expanding to embrace the wider economic bottom line

Corporate governance is now firmly on the agenda

2004 sees a raft of new entrants and rapidly climbing scores

‘It’s half empty’

Well over 50,000 multinational companies still fail to report

However high the 2004 scores, the focus is still on reports rather than action

Few companies link their ‘non-financials’ with their ‘financials’

Very few boards yet understand the connections between corporate governance and the triple bottom line agenda

Forewords

SustainAbility foreword

Risk & Opportunity marks both the tenth anniversary of our first report benchmarking survey with the United Nations Environment Programme — and the beginning of a new era. For many years, corporate environmental, social and sustainability reporting have been struggling to establish themselves as legitimate components of market disclosure and communication. Now that they are established, as the results of this latest survey demonstrate, the question is: How can corporate disclosure, reporting and communication be further evolved to help markets engage and manage new risks and opportunities?

Throughout, our work has been driven by three hypotheses about corporate transparency, disclosure and reporting. These are that:

— Sustainable development is more likely, and likely to be achieved more effectively and efficiently, where there are high levels of trust.

— Trust in business and in markets is likely to be strongest and most resilient where there are high levels of transparency and accountability.

— Triple bottom line reporting is most likely to evolve rapidly if the process is made competitive, with a combination of voluntary reporting standards and benchmarking. Imposing legal requirements too early, we argue, would trigger defensive reactions in business.

We hope that the results of this latest benchmark survey will be both interesting and useful to reporting companies and report-users alike. SustainAbility routinely assesses whether it ought to draw a line under its reporting and benchmarking activities, on the basis that we have pushed it as far as it can be pushed. But each time, to date, we have concluded that there is considerably more potential — and that other players are unlikely to fill our niche. That, at least, is our analysis. Tell us what you think. An e-mail address is given below for each of the primary authors.

SustainAbility would like to extend our thanks to the sponsors of this research; without their support the project would not have gone ahead.

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Nick Robinson
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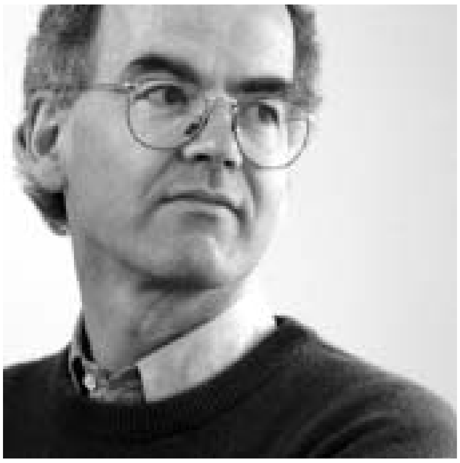
Standard & Poor's foreword

We are delighted to have been asked to participate in this research project in conjunction with SustainAbility and the United Nations Environment Programme. At Standard & Poor's our primary mission is providing high quality and independent data, analysis and risk assessments to global financial markets. We view robust transparency and disclosure as key components of a healthy financial marketplace, and also recognise the growing importance of non-financial disclosure in the overall assessment of a company's risk profile.



John Elkington

Judy Kuszewski

Nick Robinson

We are still at the beginning of a journey to address sustainability factors more systematically in our own analytical processes, with a view to relating these meaningfully to our risk assessments. We contributed to this project a list of our credit ratings to correspond with the list of the companies benchmarked. However, Standard & Poor's did not participate in the identification or the ranking of those companies in this study from the perspective of sustainability reporting.

Our involvement in this project largely focused on dialogue with our friends at SustainAbility regarding the different language and concepts used by professionals in operating in the areas of sustainable development and the financial markets. Without diminishing the overall complexity and richness of sustainability, one specific way where this language gap can be bridged is to view this as an area of risk management for the purposes of companies and investors. Though it is also clear that principles have a fundamental role to play as well.

Again, this is a journey, and we expect that progress will be made to bridge the worlds of sustainable development and the financial markets. Both worlds still have much to learn from each other, and we look forward to participating in further dialogue and research in this area.

George Dallas
Managing Director
Standard & Poor's

UNEP foreword

Since the 1990s there has been a growing effort to improve our ability to quantify the economic, environmental and social performance of companies. As *Risk & Opportunity* shows, the sustainability reporting pioneers are now breaking new records. And they are being followed by growing numbers of companies from all parts of the world embarking on sustainability reporting.

UNEP is pleased to see the dominance of GRI reporters and Global Compact participants in the Top 50 reporters. The Global Reporting Initiative (GRI) has no doubt played a key role in providing a standardised framework or compass along the journey. Whilst engaging early movers in a multi-stakeholder process to define internationally recognisable beacons, it also helped newcomers to cut transaction costs as they find their way in the sustainability landscape. But much work remains to be done. Despite tremendous uptake in triple bottom line reporting and GRI use, a mass of companies out there are not doing sustainability reporting as yet. Some adopt a wait and see strategy. Others have concerns related to resources and capacity. If we are to enter a new era in which financial reporting and sustainability reporting becomes part of an integrated package, we must enable newcomers and smaller companies to leapfrog — to take shortcuts to reporting and managing what is material.

Current activities under the GRI to develop sector supplements and a special introductory handbook for small and medium-sized enterprises (SMEs) are important milestones as we move into a new era of disclosure, reporting and communication. The support of the United Nations Foundation and others in this is greatly appreciated.

Let me also thank the SustainAbility team for their excellent research and analysis. They have enabled us to meet the high expectations associated with our joint *Engaging Stakeholders* and *Global Reporters* survey programs. The insights from Standard & Poor's have also been extremely valuable in providing an insider's view from the rating and financial sector. Finally, our thanks to the members of the International Selection Committee for their expertise and insights.

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George Dallas

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Executive Summary

Surveying a sample of 100 reports from around the world, *Risk & Opportunity* benchmarks an independently selected sample of 50 of the best, the 'Top 50'. We also briefly discuss the 'Other 50' on pages 29—30.

The financial sector — insurers, reinsurers, lenders, investors, analysts — is beginning to wake up to a range of non-financial issues. Even the best current non-financial reporting by companies may not yet meet their needs, but the convergence of the financial and non-financial worlds is now under way. This is a key conclusion of *Risk & Opportunity*, SustainAbility's sixth benchmark survey of corporate non-financial reporting with UNEP — and our first in partnership with Standard & Poor's.

The good news is that this latest survey finds that some companies have made massive progress in responding to demands for improved transparency on key issues of corporate responsibility. Underscoring the trend, the Top 50 rankings are rocked by a massive influx of new entrants (Figure 01 and pages 20—29). But the bad news is that most companies still fail to identify material strategic and financial risks and opportunities associated with the economic, social and environmental impacts captured by the 'triple bottom line' agenda.

Risk & Opportunity considers the question: Is the glass of non-financial (and wider sustainability) reporting currently half full, as enthusiasts might argue, or half empty, as some critics allege? The evidence suggests a positive assessment, though there are still major gaps to be closed in the linked fields of disclosure, reporting and communication.

Key Conclusions

Key findings of the 2004 survey include:

— Leading companies have made significant improvements in the quality of their non-financial reporting since 2002.

— Corporate governance is an area where the quality of coverage has jumped strikingly. But it seems that boards do not yet grasp the evolving links between corporate governance and the triple bottom line agenda.

— With the growing focus on corporate governance (pages 10—16), the spotlight is often on compliance and on financial integrity, rather than on the 'beyond compliance' agenda — including wider ethical, social and environmental issues.

— Interestingly, the overwhelming majority of our Top 50 companies also have investment grade credit ratings (pages 13 & 21). While it would be inappropriate to suggest causation here, it is striking that enhanced transparency and disclosure via sustainability reporting is so clearly linked to companies that display strong levels of credit quality, a widely-recognised indicator of operating and financial stability.

— Even the best reports suggest continuing, fundamental weaknesses in companies' governance and, most particularly, in their ability to identify, assess and manage priority non-financial issues.

The Top 50

The 2004 results show a number of striking shifts. Record numbers of companies now score above 50% in our rating (page 22), highlighting a substantial improvement in the overall quality of the reports benchmarked — and indicating that reporting has stepped up a gear in many organisations.

For the first time we have one company, Co-operative Financial Services, passing the 70% mark on our benchmark, with other companies — Novo Nordisk, BP, British American Tobacco, BT, BAA, Rabobank, Rio Tinto, and Shell — following very close behind.

Corporate governance is an area where the quality of coverage has jumped strikingly.

Twenty-six (52%) of the Top 50 are new entrants to the survey, a reflection of growing energy and sophistication across the board, and of new and innovative approaches to reporting. While those companies that have dropped out of the Top 50 from previous surveys are in most cases still publishing high-quality reports and even in some cases improving, the results show that they are not improving as quickly as the field in general.

The GRI Rules

Companies using the Global Reporting Initiative (GRI) sustainability reporting guidelines to shape their reporting dominate the sample. Forty-seven (94%) of companies in the Top 50, and 45 (90%) of companies in the Other 50 are openly referencing GRI.

It is clear that GRI has been enormously successful in achieving the widespread adoption and acceptance of the guidelines. However, with non-financial reporting reaching critical mass, GRI is at a critical stage in its evolution (pages 38–42). Increased standardisation of reporting brings both risk and opportunity — opportunity to influence hundreds more companies than previously, coupled with risks in the form of lower rates of innovation.

Assurance & Materiality

At a time when trust in business is still low, many reporting companies look to assurance service providers to help restore stakeholder confidence. The great majority of reports in the Top 50 (39 or 78%) include a discussion of external assurance (pages 32–35). However, there is great variety in their approaches to assurance. Where used, emerging standards — notably the AA1000 Assurance Standard — appear to have a positive impact on the quality and utility of assurance statements.

Meanwhile, 'materiality' has emerged as one of the biggest conceptual challenges for corporate reporters and stakeholders in recent years (page 35). A company's process for identifying material issues is generally complex, and this is likely to be the focus of considerable energy and research in the near future.

Our analysis reveals that most companies fail to give any real insight into what they are reporting on and why they are doing so. With materiality in mind, a refined analysis of the Top 50 produced striking results: an average 9% drop in scores and a significant reshuffling of the rankings (page 36).

Global Reporters 2010

Our final section looks at the future of reporting (pages 43–49), charting four possible trajectories and spotlighting some of the risks and opportunities likely to be associated with each. Briefly stated, the four trends are:

- Standardisation
  An accelerating shift towards common formats for non-financial reporting
- Consolidation
  An energetic shake-out of the concepts, content and language of non-financial reporting
- Regulation
  The emergence of government mandated non-financial reporting
- Integration
  Growing attempts to merge, or blend, much of non-financial reporting with financial reporting

Of these, the first two are likely to proceed much faster than the last two, but all four will be strikingly evident over the next decade. *Risk & Opportunity* concludes by offering a total of 10 recommendations for four groups of people (page 52): CEOs and corporate boards; CFOs and investor relations people; corporate responsibility and sustainability professionals; and investors and other stakeholders.

01 The 2004 Top 50 Companies

Company	Score %	Rank
Co-operative Financial Services	71	1
Novo Nordisk	69	2
BP	66	3
British American Tobacco	64	4
BT Group	64	4
BAA	63	6
Rabobank	61	7
Rio Tinto	60	8
Royal Dutch/Shell Group	60	8
HP	59	10
Unilever	59	10
Anglo American	58	12
Statoil	55	13
Kesko	54	14
Manaaki Whenua	52	15
Natura	51	16
BHP Billiton	51	16
United Utilities	51	16
Veolia Environnement	51	16
Ford Motor Company	51	16
Lafarge	50	21
Bristol-Myers Squibb	49	22
SABMiller	49	22
Volkswagen	49	22
KarstadtQuelle	48	25
MTN Group	48	25
RWE Group	48	25
Sasol	48	25
Diageo	47	29
Novartis	47	29
adidas-Salomon	47	29
General Motors	47	29
ING Group	47	29
Cadbury Schweppes	46	34
Matsushita Electric Group	46	34
Chiquita Brands International	45	36
Suncor	45	36
Total	44	38
Daiwa Securities	43	39
Philips	43	39
British Airways	43	39
Baxter	42	42
Carrefour	42	42
Starbucks Coffee Company	42	42
Sony	41	45
Deutsche Telekom	41	45
Ito Yokado	40	47
Barclays	39	48
Premier Oil	39	48
Gap	39	48

Introduction
Towards Stage 3 Reporting

1

Major changes are shaking up our Top 50 and the evidence suggests that the pace of change will increase as we move towards Stage 3 accounting and reporting.

Risk & Opportunity reveals that striking progress has been made in both corporate reporting and assurance. No fewer than 26 companies break into our Top 50 (page 21) for the first time. And record numbers of companies are scoring well above the 50% mark, while the first company breaks through the 70% barrier.

In the ten years since SustainAbility and UNEP launched our first international benchmark survey of corporate non-financial reporting, the number of reporting companies has exploded, the overall quality of reporting has improved considerably and the range of issues addressed has broadened spectacularly. This last trend is highlighted by the fact that our 1994 benchmark survey focused on corporate environmental reporting, whereas from 2000 the focus has been squarely on corporate sustainability reporting.

Risk & Opportunity is our sixth benchmark survey, all of which were undertaken with UNEP, and the third in our 'Global Reporters' series. Each survey has aimed both to reflect current realities and to push the envelope:

— In 2000, *Global Reporters* introduced a new benchmarking methodology, and explored the non-financial (or 'sustainability') reporting agenda in the context of globalising markets.

— In 2002, *Trust Us* looked at the role of reporting in the context of declining levels of trust in the wake of the collapse of the 'New Economy' and high-profile corporate scandals.

— In 2004, working alongside both UNEP and Standard & Poor's, we began the task of addressing two sides of the accountability coin, risk and opportunity.[01]

The selection of reports for our Top 50 (page 21) and Other 50 (page 24) was the responsibility of an international panel.[02] Once again, our methodology has been updated, as described on pages 17—19. But the process has been carefully managed in such a way as to ensure comparability between the 2002 and 2004 benchmark results.

This year, for the first time, we also introduce a new tool — the 'Materiality Multiplier' — to adjust the rankings to better reflect companies' coverage of their internal processes of issue identification and prioritisation (pages 35—37). The results are striking. The average drop in scores after the Multiplier was applied was 9%.

Our cover image, with the non-financial reporting glass seen as either half full or half empty, reflects a number of dichotomies. For example, is the real challenge here to get companies to improve their processes — or is it to get them to improve their performance? Or, alternatively, is this area about risk management or is it about new opportunities? As is often the case, it's not either/or but both/and.

In terms of the first dichotomy, *Risk & Opportunity* largely focuses on processes, as with corporate governance (pages 10—16) or materiality (pages 35—37), in the conviction that if we can get the processes right the performance will follow. Indeed, we think it is extremely unlikely that companies would penetrate our Top 50 without achieving excellent performance in at least some parts of their businesses. But that is an hypothesis which needs to be — and will be — tested.

02 Reporting Eras

	Stage 1	Stage 2	Stage 3
Timescale	1500s — waning	1990 — ongoing	2010 — onwards
Focus	Single bottom line, profit and loss, externalisation of costs	A world of fission, with experimentation on multiple bottom lines, coupled with new understanding of externalities and risk	Fusion world, focusing on reintegrated bottom line (e.g. blended value[04]); externalities increasingly internalised
Cutting edge	Accountants	Civil society	To be determined

The Wider Context

We also look at the bigger picture. One of the most important drivers of the reporting agenda since 1997, for example, has been the Global Reporting Initiative (GRI). The fact that over 500 companies now report along GRI lines is encouraging — and suggests that we are close to achieving critical mass in this crucial area of market transparency and accountability.

That said, GRI still faces major hurdles in driving the group of GRI-reporting companies to between 1,500 and 2,000 (pages 38—42). Nor should we be complacent on reporting generally. When confronted with statistics on the sheer number of companies not reporting in any form, it is easy to conclude that the reporting glass is half empty. But it is worth thinking of these trends in a wider context.

We increasingly think in terms of three great eras of accounting and reporting. As Figure 02 suggests, 500 years of single bottom line accounting and reporting began in 1494 with the publication of the work of Fra Luca Pacioli, the 'Father of Accounting'. His 'ledger' included assets — receivables and inventories — liabilities, capital, income and expense accounts. For centuries, this 'Stage 1' accounting and reporting helped spur the spread and evolution of capitalism.

Then, from the 1960s, a growing range of civil society organisations began to explore ways to capture wider social and environmental aspects of company performance. Most of these initiatives failed, but they prepared the ground for later work.

Some governments, for example, began to force corporate disclosures in new areas, as with the US Toxic Release Inventory (TRI), introduced by the Emergency Planning and Community Right-to-Know Act of 1986 (EPCRA) and expanded by the Pollution Prevention Act of 1990.[03]

Partly as a result of such pressures to disclose — and partly as a result of increasingly effective NGO campaigns — 'Stage 2' corporate reporting and communication began to take off from 1990. For years, companies had said they wouldn't, couldn't report on environmental or social issues. The logjam began to break up with the publication of voluntary environmental reports by Monsanto and Norsk Hydro. By 1993, when we produced our first report on company environmental reporting, *Coming Clean*,[05] we were able to identify just over 70 such reports.

These early experiments, in turn, ushered in a new era of intense experimentation in accounting for and reporting on multiple dimensions of corporate value added. Concepts like the *triple bottom line* took root and spread like wildfire. The fact that the triple bottom line agenda was first introduced in 1994, exactly 500 years after Pacioli's Stage 1 revolution, was no more than a happy historical accident, but symbolised the new era of accountability, reporting and assurance just getting into its stride.

Eventually, many aspects of current voluntary reporting will need to become incorporated in mandatory disclosure requirements, but the process will not be smooth. Scandinavian countries are already fairly well advanced in this area. In France, too, the NRE (Nouvelles Régulations Économiques) law came into force in 2003 and requires listed companies to report against a range of social and environmental indicators.

But the first round of reporting produced relatively few reports and what did appear was relatively weak in quality. No company at that point fully complied with the law[06] — nor do they now.

In the UK, meanwhile, publicly quoted companies will have to produce an Operating and Financial Review (OFR) from 2005.[07] Some 1,300 companies will be required to provide a balanced, comprehensive and forward-looking review of the company's development and performance, together with the main trends and factors likely to affect its prospects. Not a revolution, particularly since environmental and social issues will only need to be covered 'as necessary', but at least a supportive framework while non-financial reporting is being introduced into company law.

Governance is Issue No.1

If initiatives like the OFR requirement can be made to work, similar regulatory requirements are likely to be introduced at European Union level during the next decade. The pace of change in most parts of Africa, Asia and South America is likely to be much slower, however.

But life is full of surprises. As a reality check on the conclusions and predictions presented in *Risk & Opportunity*, Figure 03 revisits the 'Ten Transitions' we forecast in 1996, in *Engaging Stakeholders*. Overall, the predictions seem to have been sound — even if progress has not always been as fast as we might have liked.

One of the biggest jumps between 1996 and 2004 has been in the area of our seventh transition, corporate governance (pages 10—16).

Record numbers of companies are scoring well above the 50% mark, while the first company breaks through the 70% barrier.

01 In 2002, *Trust Us* spotlighted what we saw as emerging 'clusters of risk and opportunity'.
02 Selection panel members are listed on page 19.
03 www.epa.gov/tri/
04 www.blendedvalue.org
05 SustainAbility, DTTI & IISD, *Coming Clean*, 1993.
06 Utopies, SustainAbility & UNEP, *The Impact of Mandatory CSR Reporting in France*, 2003.
07 www.dti.gov.uk/cld/financialreview.htm

While a surprising number of CEOs still dispute any significant connection between the worlds of corporate governance and non-financial disclosure and reporting, a growing number of companies acknowledge the potential connections in their latest reports.

The challenge is to convince not just CEOs but also the boards, trustees, company secretaries and chief financial officers that there are duties of diligence and care which require them to align their strategies both with future market trends and wider societal priorities. As Bob Massie, of CERES and GRI told us, 'board members need to be fitted with the equivalent of night-vision goggles to take them beyond the landscape of immediate returns.'

One issue not directly covered in Figure 03 is the spread of reporting generally. We have covered the issue of non-reporting,[08] but as far as the penetration of reporting into the business mainstream is concerned, the evidence is fairly positive — or, to put it another way, the non-financial reporting glass appears to be half full.

In terms of overall levels of reporting, when KPMG carried out a survey of corporate sustainability reporting in 2002, they concluded that of the top 250 companies in the Global Fortune 500, almost half (45%) had produced an environmental, social or sustainability report.[09] And in a parallel survey of 19 countries it was found that just under a third (28%) of the Top 100 companies were producing such reports. These results compare with 35% and 24% respectively in 1999.

03 Ten Transitions

	Established focus	Emerging focus	Status 1996	Status 2004
1	One-way, passive communication	Multi-way, active dialogue		
2	Verification as option	Assurance[10] as standard		
3	Single company progress reporting	Benchmarkability		
4	Management systems	Life-cycles, business models,[11] strategy		
5	Inputs and outputs	Impacts and outcomes		
6	Ad-hoc operating standards	Global operating standards		
7	Public relations	Corporate governance		
8	Voluntary reporting	Mandatory reporting		
9	Company determines reporting boundaries	Boundaries set through stakeholder dialogue		
10	Environmental reporting	Triple bottom line performance		

Significant progress

Beginning to make progress

Little progress

Columns 1 and 2 are from *Engaging Stakeholders*, 1996

[08] SustainAbility & UNEP, *The Non-Reporting Report*, 1998.
[09] KPMG, *International Survey of Corporate Sustainability Reporting*, with the University of Amsterdam, 2002.
[10] This was originally 'verification' in 1996, but we have broadened the term to 'assurance' since it better fits the emerging reality (see page 32).
[11] The phrase 'business design' was used in 1996, by which we meant what would now be described as 'business models'.
[12] ACCA & Corporate Register, *Towards Transparency: Progress on Global Sustainability Reporting*, 2004.
[13] The triple bottom line refers to economic, social and environmental value added — or undermined — by business or other human activities.

By 2003, some 1,500 annual report series had been documented,[12] although the evidence suggests that the rate of progress is slowing in some areas. As ACCA and Corporate Register concluded in 2004, 'growth [in reporting] in Europe is slowing and in North America it is becoming static, but in Japan and Australasia it remains dynamic.'

Where next?

Some future trends in reporting are discussed in Chapter 6 (pages 43—49) and our conclusions and recommendations can be found on pages 50—52. Needless to say, having coined the term *Triple Bottom Line* (TBL),[13] we remain committed to continuing our work on the TBL agenda and the development of related concepts and tools. That said, we conclude that the next decade, from 2005 through 2015, will probably see an accelerating process of convergence and consolidation in this area. Figure 02 may show 2010 as the take-off point, but this mega-transition will take decades to effect.

On the basis of ongoing discussions with leading corporate reporters, we believe that Stage 3 accountability and reporting will increasingly focus on the integration of different forms of value creation (underscoring, in the process, the growing importance of business models). We are likely also to see increased interest in related approaches to accounting, reporting, assurance and, crucially, corporate and market valuation.

None of this will be easy. In many ways, Stage 3 is going to be even more challenging to get right than Stage 2 multidimensional accounting and reporting has been. A key part of the task will be to integrate triple bottom line and blended value thinking into business models and brand-level communication with customers, consumers and investors.

Disclosure, Reporting and Communication

One area of confusion in corporate accountability is that the term reporting is used to cover many disparate areas and activities. To help mitigate some of this confusion, we offer here three linked terms: Disclosure, Reporting and Communication. These are not 'new' terms, but we would like to suggest that they can be used to draw more concrete distinctions between different forms of information sharing.

Disclosure

Disclosure can be thought of as information, generally standardised and easily comparable, that companies are required to make public — whether via regulation or custom. Such information does not vary between companies. Disclosure is based on people's right to know, regardless of the specific circumstances of individual companies. Often, disclosure involves information companies would rather not share. The range of triple bottom line disclosures is likely to grow in coming years, as efforts to develop standard indicators and requirements continue at national and regional levels.

Reporting

The key focus of reporting has often been to provide a 'one-stop shop' for information needed both by companies and by their stakeholders. This area has been the main focus of our benchmarking work. And some of the best practice reports featured in *Risk & Opportunity* draw on data that were originally compiled to meet government or other disclosure requirements. In the short term, we see a growing desire on the part of business to stem the flow of questionnaires and other demands for triple bottom line information. The London Stock Exchange proposal to provide a 'one-stop shop' for data that would otherwise be gathered by a multiplicity of investment funds and other questionnaires is one of a likely flood of initiatives designed to simplify the reporting challenge for companies.

Communication

But the longer-term challenge will be to exploit every form of corporate communication — including web-based, broadcast, brand association, point of sale and other channels, to inform and engage both internal and external stakeholders. Communication encompasses a wide array of opportunities to inform, respond to and engage stakeholders. The challenge here will be to evolve today's 'one-stop shop' reports into the more targeted, informative products and processes that 21st-century markets will demand.

Different lenses

Later on in *Risk & Opportunity* we feature a number of impressionistic images of where the transparency revolution might take us (pages 44, 46 and 48). We wondered what it would be like if citizens and consumers could use a device that presented them with 360° information on products and services. Once akin to science fiction, such tools are likely to be everyday reality within a decade or so.

Governance
The Hottest Topic

2

What links corporate governance, market risk and sustainable development? SustainAbility Chairman John Elkington [JE] explores the agenda with George Dallas,[GD] Managing Director of the Standard & Poor's Corporate Governance Practice, SustainAbility Executive Director Peter Zollinger [PZ] and Shell Chairman Jeroen van der Veer. [JV]

JE The debate about corporate governance is white hot. We predicted its emergence as an issue in 1996, but even so the speed of recent developments has been extraordinary. Peter, in 2001 you worked with Jane Nelson of the International Business Leaders Forum (IBLF) on the growing overlap between corporate governance and the wider stakeholder agenda.[14] What's going on — and what are the links with corporate reporting?

PZ The immediate pressure is the series of corporate scandals, but the agenda has been building for some time. As a result, investor surveys routinely confirm shareholders' interest in assessing corporate governance performance and indicate a willingness to pay a premium for well-governed companies.[15]

Improved disclosure and reporting are prerequisites for improved governance. Key functions of mainstream corporate governance include setting strategic direction and board oversight, and ensuring a framework for accountability and risk management. As we concluded in our 2001 report *The Power to Change*, sustainable development increasingly cuts across these functions. No new responsibilities need to be added to already over-burdened boards. Instead, the context of existing ones needs to be broadened and sustainability priorities embedded.[16]

In 2002's *Trust Us* [17] we noted that corporate governance was becoming an increasingly important component of sustainability reporting. Leading corporate reporters, such as SABMiller, pioneered by including details of their governance processes. Today, this trend has evolved dramatically among our Top 50 companies (page 21).

JE George, before we get on to your take on why and how all of this impacts corporate risk, when — and why — did Standard & Poor's get involved in corporate governance?

GD We got involved because we provide independent risk analysis to financial stakeholders. These include — in one form or another — creditors, shareholders and insurers. The assessment of risks to financial stakeholders inevitably involves considerable financial analysis of earnings, cash flows, balance sheets and off balance sheet risk exposures. Much of this analysis is quantitative in nature. At the same time a more 'holistic analysis', which we would do to assess credit ratings, also focuses significantly on more qualitative aspects of company performance, including the assessment of country influences, industry factors, competitive dynamics, and company management and policy — all with regard to their impact on the quality and sustainability of a given firm's operating and financial performance.

Among these various qualitative factors, the assessment of a company's management and governance is possibly the most subjective to incorporate meaningfully into an objective analytical process. It is in this context that Standard & Poor's has begun to address more systematically the linkage between a company's management and governance processes and its overall financial risk profile. We formed a specific corporate governance unit in 2000 to provide comprehensive evaluations and benchmarking of corporate governance to financial stakeholders. But I should stress that our approach to governance analysis is underpinned ultimately by principles rather than rules; we cite the OECD principles of fairness, transparency, accountability and responsibility as our guiding stars in this regard.


George Dallas


Peter Zollinger

JE What information sources do you rely on? And where do social and environmental factors fit in?

GD In our corporate governance analysis, our assessment of stakeholder relations focuses on key non-financial stakeholders, including employees, customers, suppliers and local communities. We mainly want to get a sense of the quality of the company's transparency and disclosures relating to social and environmental issues, and we also look for evidence where these issues may have been managed poorly.

Our approach to date is fairly limited; we recognise scope for growing sophistication. Information sources include: annual reports, websites, regulatory filings, internal and external social impact reports, media coverage, NGO reports and independent assurance reports, if they exist.

For busy analysts who are trying to narrow down (not add to) the driving factors behind an investment decision or risk assessment, social and environmental analysis of stakeholders' interests in some cases might at best be viewed as an 'immaterial' diversion — and at worst as a distraction. In other cases, however, this can be an important factor, and we are trying to become more systematic about flagging situations where these issues may be of greatest importance.

So here's a way to think about that. While the classical theory of the firm views a company as a profit maximising entity, theory also recognises that profits are inevitably maximised subject to practical constraints. But constraint functions exist, though they may be challenging to articulate.

These constraints do not relate simply to the need to comply with prevailing laws and regulations; they also relate to the need to maintain constructive relations with key non-financial stakeholders.

Whether you want to minimise operational risks or maximise sustainable competitive advantage, it's important to recognise that non-financial stakeholders have an important role to play in the success of a firm — and in the quality of an investment opportunity it presents to financial stakeholders. So even for those wedded to a classical economic approach it can be argued that stakeholder issues are not 'externalities'; rather they can be viewed as critical 'internalities'.

In practical terms, for example, we see this embodied in Johnson & Johnson's mission statement, which cites the satisfaction of the needs of doctors, nurses, patients, employees, suppliers and communities as preconditions for the achievement of economic returns for shareholders. In this regard the relations that a company has with its key stakeholders can be critical to its own long-term financial and operational sustainability — and not just that of society more broadly.

Financial Markets Not Yet Seen as Key Audience

JE OK. So, Peter, do the 2004 Global Reporters results give you any confidence that leading companies are really tackling these issues in ways that will help financial markets get a handle on the relevant risks and opportunities?

PZ There's hardly a report among our Top 50 which does not present a company's core values or 'The Way We Do Business'. Information on basic policies, committees and management systems has also greatly improved since 2002.

Results from the 2004 benchmark survey indicate that reporting by companies on the sustainability context of their operations and their respective commitments has improved 19%, which is impressive.

Most reporters now appear to accept that no meaningful approach to the sustainability agenda is possible without clarity on a company's most fundamental principles and values. Key aspects of what could be called the 'constitutional level' of a firm's governance are the mapping of board and committee structures, memberships and responsibilities. Almost all (94%) of the Top 50 reports now refer to corporate governance — and the topic is mentioned in many CEO forewords.

JE But what's the *quality* of that reporting?

PZ We could ask three linked questions: Are companies doing a good job in explaining the implications of the sustainability agenda for their business prospects, long term strategy and valuation? Are they discussing emerging risks — or opportunities — in a meaningful way? And are they convincing shareholders of their capabilities to cope with the ever more demanding global business environment?

Based on the 2004 results, the answers to all three questions must be no. Disappointingly, explicit and clear references to long term strategy and risk management in the particular language of these disciplines are rare, even among the Top 50 reporters. The thinking simply isn't joined up. It's very hard to see whether sustainability touches directly on the tasks of these mainstream governance bodies and core functions of direction and oversight. Generally, it seems, sustainability is dealt with elsewhere in the companies, as if these worlds never touch one another.

The thinking simply isn't joined up. It's very hard to see whether sustainability touches directly on the tasks of these mainstream governance bodies and core functions of direction and oversight. Generally, it seems, sustainability is dealt with elsewhere in the companies, as if these worlds never touch one another.
Peter Zollinger

[14] SustainAbility & International Business Leaders Forum (IBLF), *The Power to Change — Mobilising board leadership to deliver sustainable value to markets and society*, 2001.
[15] McKinsey, *Global Investor Opinion Survey on Corporate Governance*, 2002.
[16] SustainAbility & IBLF, *The Power to Change*, 2001.
[17] SustainAbility & UNEP, *Trust Us*, 2002.

We have to conclude that mainstream investors, regulators and other key stakeholders with an interest in good corporate governance performance are not high on the minds of those who write today's sustainability reports. As a result, little help is given to investors in terms of understanding the meaning of social and environmental performance in a financial — let alone a wider economic — context.

While companies go to great trouble to explain what we might call their *governance for sustainability* from a broad stakeholder perspective, they almost never articulate the relevance to shareholders. And such reporting on governance for sustainability as there is rarely lives up to its potential because we learn so little about process and practice in real terms. Generic descriptions and repetitions of commitments, structures and systems are almost interchangeable.

GD Exactly. We also feel that we are challenged with the ability to separate form from substance in sustainability reporting. Our analysts are often frustrated with regard to the interpretation of sustainability reports. Many appear the same, laden with wholesome images and platitudes. There is a notable tendency for such reports to read like public relations polemic rather than risk assessment reports.

JE Fine, but let's try to be positive. Who are 2004's top scorers in terms of corporate governance? And which reports struck you as representing emergent best practice?

PZ I would like to mention Novo Nordisk, with its Novo Nordisk Way of Management, a convincing approach to embedding sustainable development in the company's culture and corporate governance.

And Gap, Rio Tinto, SABMiller and Statoil all demonstrate how to integrate sustainability into core corporate governance processes at board level. BAA and Unilever also offer convincing strategy discussions, while Philips signals inclusion of its supply chain by giving its chief procurement officer, who is also a member of the Group Management Committee, a leading role in integrating sustainability.

JE That's certainly progress from a 2002 perspective. George, you have already mentioned the M-word, *material*, which surfaced in both our 2002 and 2004 surveys. We'll get into more detail on materiality in Chapter 5, but where does materiality fit in for S&P?

GD Even if we can reliably identify good or bad social and environmental performance through company disclosure and related analysis, we have to ask: How important is this in the context of the many other risk factors that are traditionally more rigorously addressed by financial analysts — particularly when the company appears to be in nominal compliance with prevailing laws? How should sustainability issues affect a company's credit rating, equity discount rates and insurance underwriting? This is the area addressed by discussions of materiality.

The answers are likely to be company or case specific. I should also warn that, at this point in time, and to the extent that positive or negative conclusions can be clearly reached, there is likely to be a greater tendency for analysts to penalise poor social and environmental performance — as a risk factor — rather than to give positive credit for good performance. This is likely to be the case until there is clearer empirical evidence linking social and environmental factors as drivers in a company's out-performance relative to peers.

Companies Don't Link Sustainability With Risk

JE Peter, your thoughts on materiality?

PZ From a corporate governance point of view, risks are material if they have the potential to affect valuation, creditworthiness, longevity and vulnerability to litigation and operational disruption — or intangible assets, such as brand value and reputation. It can be safely assumed that most companies identify, assess and manage such risks to the extent that they are aware of them.

However, only a few publicly acknowledge that 'non-traditional' risks have the potential to be significant. Even among our Top 50, most shy away from mentioning those risks and explaining them, confirming the results of an earlier study of FTSE 100 companies which SustainAbility undertook in collaboration with an institutional investor.[18]

Regulators and stock market authorities such as the UK Financial Service Authority (FSA), through its Combined Code on Corporate Governance, have broadened the notion of risk, embracing wider issues and making boards accountable for effective internal control.[19] Companies are required to identify, evaluate and manage their significant risks, including environmental, social, probity and reputation risks. Boards of directors are also called upon to review regularly reports on the effectiveness of the system of internal control in managing key risks, and to undertake an annual assessment.

Sustainability reports would be the natural vehicle to use in moving beyond compliance. However, the latest reports stick narrowly to generic language, saying that companies are 'compliant' with best practices on internal control.

We have to conclude that mainstream investors, regulators and other key stakeholders with an interest in good corporate governance performance are not high on the minds of those who write today's sustainability reports.
Peter Zollinger

We see simple statements noting that 'no risks considered material have been identified'. For example, BT's 2003 report states that 'We currently identify no social, environmental or ethical risks that would have a material impact on our business.'

It can be done differently. Suncor, for example, stands out by estimating its maximum cost exposure through greenhouse gas emissions, as does Chiquita — which includes a complete environmental risk assessment in its report.

JE George, in terms of risk management, what would S&P like to see a company doing?

GD Four things. First, in our assessment of stakeholder relations we encourage good public reporting on key areas of employee, community and environmental activities that address concerns of non-financial stakeholders. Top reporters will either use the framework of the Global Reporting Initiative or report in a similar fashion to this framework (see pages 38—42).

Second, we look for evidence that the company has identified material social and environmental risks and has introduced processes and controls to manage and govern the company with regard to these risks. These matters should have explicit board oversight.

Third, we would be nervous to see evidence of problematic relationships with non-financial stakeholders that could impair longer-term performance.

And, fourth, we look for evidence that the company maintains proactive programs to address interests of legitimate stakeholder interest groups. The fundamental principle underlying these factors is that of responsibility.

JE And what would ring the alarm bells?

GD Let's take the same four areas. Alarm bells would ring if there was no or minimal social reporting. This would be particularly negative for companies that operate in sectors that have significant social or environmental impacts. We would also be concerned if there was evidence that a company's public reporting was distorting its performance with regard to social and environmental issues to present a more positive image than justified by its processes and track record.

Second, warning signs would include evidence that the company had not identified material social and environmental risks — and that it lacks processes and controls to manage and govern itself with regard to these risks. Equally worrying are cases where it is clear that board oversight of social and environmental issues is either non-existent or minimal.

Third, cases where there is a documented history of employee disruption, environmental litigation or conflicts with local communities — particularly where these potentially have a material impact on the company's finances or operations. And, fourth, cases where a company fails to maintain proactive programs to address stakeholder interests, with evidence that this is harming the company's reputation or long-term performance.

Transparency Can Add Value

JE And now, Peter, the $64 billion question? What links have we found between our work on reporting and S&P's work on risk, rating and valuation?

PZ The Holy Grail in all of this would be to find a direct link between a company's financial performance and its competence in sustainability reporting, hopefully with a link back to its governance structure. Frankly, we are still a long way off. That said, we thought we should at least start the ball rolling. Initially we compared the Top 50 companies' benchmark scores with the data from Standard & Poor's report on Transparency and Disclosure,[20] which uses a rigorous methodology to give a score on company transparency and disclosure activities.

Because the S&P study does not include specific information on sustainability, we thought it would be interesting to see whether companies who rate highly on the T&D study also rated highly on our benchmark. Unfortunately, the results were inconclusive, though there was a small positive correlation between the two. One key problem: our relatively small sample size.

However, when we looked at the S&P credit ratings of our Top 50, we did discover that — for the 41 (82%) with a credit rating, the average rating was A-, compared to the average credit rating of B- for companies in general. And all our Top 50 companies with ratings beat that average rating. [See Figure 08 on page 21 and Figure 20 on page 29 for credit ratings for the Top 50 and Other 50 companies.]

But what does this tell us? Perhaps it's simply that Top 50 companies are mainly successful large companies with the resources needed to produce reports. Or, more optimistically, it could be that well-governed companies also are more likely to both see the value in public reporting and attract high credit ratings. Cause and effect are difficult to separate here, though over time that should get easier.

Alarm bells would ring if there was no or minimal social reporting. This would be particularly negative for companies that operate in sectors that have significant social or environmental impact.
George Dallas

[18] Friends, Ivory & Sime and SustainAbility, *Governance, Risk and Social Responsibility — Snapshot of Current Practice*, 2001.
[19] See 'Combined Code', www.fsa.gov.uk
[20] Standard & Poor's, *Transparency and Disclosure Study*, 2002.

JE So that sounds like a picture of some progress, coupled with the usual plea for further research! Peter, George, a few final words?

PZ Disclosure is a prerequisite of effective corporate governance. Without it, shareholders cannot take effective decisions, nor can they exert control over management's performance and, specifically, its exercise of fiduciary duty. Similarly, other stakeholders are not in a position to make a fair assessment of a company's performance without effective, material disclosure.

Reverting to the virtue of 'corporate responsibility' has emerged as the preferred response of corporate leaders in their attempts to re-build trust after a scandal or crisis. This implies a commitment to uphold basic principles such as honesty, fairness, integrity, accountability, transparency and checks and balances in their professional relationships with all stakeholders. The future does not look good for sustainability reporting as a stand-alone exercise. Instead, leading companies will incorporate non-financial reporting in the management of their businesses on a day-to-day basis.

GD Building on that, an ongoing challenge facing analysts, investors, stakeholders — as well as the company itself — is to identify aspects of social and environmental performance that are potential keys to a firm's sustainable competitive advantage or the potential source of material risks to its operations, financial performance, reputation and valuation. Sustainability reporting can help in this context, but there is also huge scope for improvement in helping financial stakeholders better understand these issues as financial risks — to facilitate incorporation into traditional credit analysis, equity analysis and insurance underwriting.

A more detailed analysis of the links between governance, risk and sustainability by George Dallas is available at www.sustainability.com /risk-opportunity

04 Governance and Sustainability: Missing Links

For most observers and practitioners, corporate governance is about improving board structures and procedures to make a company more accountable to shareholders. The concept covers areas such as financial disclosure, transparency and audit, risk management, remuneration of directors, the separation of powers and shareholder rights. The seminal UK Cadbury Report on Corporate Governance defined corporate governance as, 'the system by which companies are directed and controlled'.[21]

The global scene is characterised by the lack of universal rules or standards in this area. Instead, myriad national codes and regulatory frameworks have emerged, reflecting the many different legal, economic and cultural environments.[22] Nevertheless, a set of emerging global guidelines and principles of good practice are emerging. The OECD corporate governance guidelines, updated in 2004, are often taken as a reference point. They are broad enough to allow comparisons across governance environments and, more importantly, to overcome potentially contentious, prescriptive approaches. The revised guidelines cover:

- elements of an effective governance framework
- rights of shareholders and key ownership functions
- equitable treatment of shareholders
- role of stakeholders in corporate governance
- disclosure and transparency
- responsibilities of the board.[23]

The last three areas refer to corporate responsibility and sustainability, and demonstrate their links to the mainstream governance agenda. In contrast to the sterile stockholder-versus-stakeholder debate, the OECD sees it to be in the enlightened self-interest of shareholders to understand and respond to wider stakeholder interests.

Corporate governance does not lend itself to easy assessment. Approaches focused on quantitative and 'tangible' information (i.e. tick-box exercises) risk missing the point as real performance largely depends on corporate cultures and practices, plus personal interpretation by the people involved. Thus, corporate disclosure, reporting and communication must also address such aspects if it is to contribute to effective corporate governance.

Equally worrying: cases where it is clear that Board oversight over social and environmental issues is either non-existent or minimal.
George Dallas

Lessons Learned: Jeroen van der Veer

The Shell Report scores well in surveys, including this one, but even attentive readers were shocked by the recent reserves scandal. Shell's new chairman, Jeroen van der Veer, explores some implications for accountability and governance. This is an excerpt of a longer interview available at www.sustainability.com/risk-opportunity

JE Jeroen, in the 2003 *Shell Report* you note that readers will see Shell's sustainability performance 'in the context of our reserves restatement in early 2004'. What impact has the restatement had on how people perceive Shell's sustainability commitments and performance?

JV The restatement of our [oil and gas] reserves in early 2004 was deeply regrettable. Some have called into question not only our financial performance but also the behaviour and values that underpin the way we work. Our reputation has been dented.

We face a considerable challenge to re-establish credibility and trust with our stakeholders. It will take time, persistence and leadership. At the same time, I am heartened by the number of stakeholders who have been able to put the events of the past year into context in relation to our ongoing work on sustainable development. This is particularly true for those who have worked with us and have seen from close up how serious our efforts are to make sustainable development an integral part of how we do our business. They know how serious our commitment is and have seen the emotional shock and deep disappointment people across Shell have felt at the reserves restatement.

In terms of our ongoing commitment, let me be very clear. Recent events have only reinforced the importance of embedding sustainable development consistently in our systems, processes and behaviour.

JE Some critics have argued that an over-emphasis on sustainable development could have distracted Shell from the real issues.

JV People who accuse us of getting distracted by sustainable development miss the mark. Indeed, I am heartened to see growing awareness in the financial community that companies — especially energy companies — ignore sustainable development concerns at their peril.

If you want to continue to succeed as an energy company in the coming decades, you need to understand and meet people's expectations for environmental and social performance, as well as delivering good technical and financial performance. That means putting solid business principles, including sustainable development, at the heart of how you do your business.

JE The reserves restatement episode might appear to suggest that a company can have ambitious business principles, proactive stakeholder relationships and rigorous internal controls — and yet that these can still be undermined by a few individuals. What, in that case, is the value of having these internal controls in the first place?

JV The value of having these controls in place is not in question for me. But nor is the fact that they clearly need to be improved. We have already tightened our controls around reserves reporting and are in the midst of a wide-ranging review of our systems and controls for ensuring compliance with all our policies and standards.

That review will lead to important improvements in how we organise and execute our controls and assure compliance.

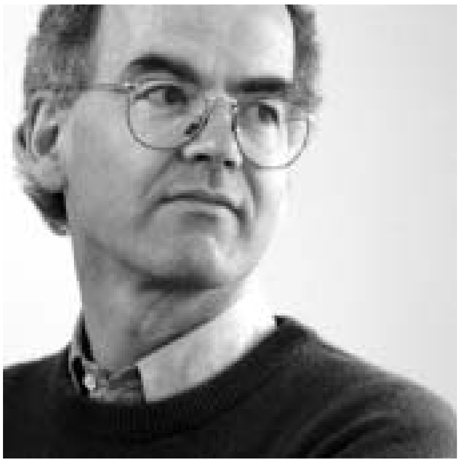
JE Do you see any need for corporate governance systems and processes to evolve to create and maintain a greater climate of openness and accountability — or will it be business as usual?

JV 'Business as usual' are not words that leap to mind when I think about the coming 12 to 24 months! We have a lot to do to rebuild trust and improve performance. A full-scale review of our structure and governance is under way to identify ways to improve decision-making, accountability and the effectiveness of leadership. The committee is looking at all options including various forms of unified boards to which a CEO would report. Nothing is being ruled out.

We are also revamping our scorecard so that staff in all parts of Shell have a stake in the success of Shell as a whole, not just their part of it. Sustainable development continues to represent a fifth of our scorecard.

JE What role do you see for *The Shell Report*?

JV We have seen how, if done honestly, reporting forces companies to publicly take stock of their environmental and social performance, to decide improvement priorities and deliver through clear targets. Our reader surveys confirm that people receiving our report come away with a significantly greater sense of trust in Shell.


John Elkington


Jeroen van der Veer

[21] The Committee on the Financial Aspects of Corporate Governance. *Report of the Committee* (The Cadbury Report), London Stock Exchange, 1992.
[22] European Corporate Governance Institute (www.ecgi.org) offers a comprehensive list of links to the major corporate governance codes around the world.
[23] Organisation for Economic Cooperation and Development (OECD), *Principles of Corporate Governance*, 2004.

JE As they did last year, Friends of the Earth (FOE) UK has published an 'alternative' report.[25] FOE draws a direct connection to the reserves issue, repeatedly highlighting 'the link between Shell's exaggerated oil reserves fiasco and its exaggerated claims about its social and environmental performance'. Fair criticism?

JV I understand the desire to make the link, but it just doesn't stand up to scrutiny. The issues we have had with local communities at some of our operations predate and, to be a blunt Dutchman for a moment, simply have nothing to do with the restatement of our reserves. We operate several hundred large industrial facilities worldwide. There are problems at some of these locations as we openly acknowledge in *The Shell Report*. These are rooted in a history of either unsatisfactory environmental performance or poor engagement with the local communities at these sites or, in some cases both. We don't shy away from that, and certainly aren't trying to sweep it under the carpet. I want those problems solved and we will solve them.

Nor does the claim that we have exaggerated our social and environmental performance hold up. We go to great pains to ensure that our reports are accurate. Independent experts and community panels give their own, uncensored views in *The Shell Report* at many of the sites listed in the FOE report. Given the care we take in checking and verifying our facts, I was disappointed by the factual errors and misleading statements found in the alternative Shell Reports.

JE Finally, Shell has been a leading reporter for years, but other companies are making rapid gains. What do you make of the competition?

05 Corporate Governance: The S&P Way

To give a sense of what rating agencies look for, Standard & Poor's company specific analytical components are:
— Ownership structure and external influences.
— Shareholder rights and stakeholder relations.
— Transparency, disclosure, audit.
— Board structure and effectiveness.[24]

Within this framework, S&P's assessment of stakeholder relations is guided by the following questions:
— How are social and environmental issues identified and managed by the company's management? What is the role of the board with regard to oversight in this domain?
— Is there evidence of problematic relationships with key non-financial stakeholder groups? This can include lawsuits, strikes, public protests or boycotts, defamatory employee or interest group commentary.
— If so, how has the company responded to these relationship problems?
— Does the company maintain an active policy of engagement to investor and stakeholder interest groups?
— Have the company or its senior officials been convicted of offences relating to its social or environmental activities?
— What is the company's relationship with government regulatory bodies?
— Are there any NGOs or public interest groups that oppose the company's activities? What is the substance of their opposition?
— Do shareholder resolutions exist that relate to social and environmental matters?
— How extensive is the company's own social and environmental reporting? Does it fully or partially disclose in accordance with the Global Reporting Initiative?
— To the extent that the company does provide disclosure with regard to its social and environmental performance, how do these external controls link to how the company is managed on a day-to-day basis? What reports, if any, does the board receive on social and environmental performance?

JV Sustainability reporting is still in its infancy. We have published only our seventh *Shell Report* last year, and more than 90 annual reports. So naturally sustainability reporting is still changing fast. I'm particularly pleased to see more substantive performance information coming into reports that in the past were mainly anecdotal — and welcome more use of the GRI. In that sense, I've never been particularly competitive when it comes to reporting. Our aim has always been to report transparently and honestly on the issues of most concern to our stakeholders, not to win a race.

On the negative side, most reports are far too long — and more or less unreadable for anyone but specialists. There is still too much 'cherry picking'. Even amongst other reporting leaders, I still see too little willingness to talk about failures and too little input from credible, and sometimes critical, third parties. The whole area of information quality, including internal controls to make sure the data provided is reliable, is another area where further work is needed.

In short, it is time to pull sustainability reports out of the hands of PR departments.

In short, it is time to pull sustainability reports out of the hands of PR departments.
Jeroen van der Veer

[24] George S. Dallas, *Governance and Risk*, Standard & Poor's, 2004.
[25] www.foe.co.uk/resource/reports/behind_shine.pdf

Methodology
Selection and Benchmarking

3

A brief account of how the process works.

Subsequent to our selection and benchmarking of the Top 50 reports, a small number of the companies benchmarked released their latest reports. We have noted the year of publication for all reports listed among the Top 50.

As the quantity and quality of reports increases, so the task of selecting the Top 50 gets progressively harder. For each of the three Global Reporters surveys to date, we have selected 100 interesting reports out of the many hundreds gathered and submitted — and then pruned these down to the Top 50. Which makes the process sound simple: it is anything but.

Collection

The process of report identification operates partly on self-selection (with companies submitting their latest efforts), part collection (for example, at conferences) and part recommendation. Early in 2004, we sent out the call for reports via SustainAbility's network, website, relevant publications and word of mouth. In parallel, we searched for the latest reports from companies that had been included in the Top 50 and Other 50 in 2002. We also gathered reports that had been shortlisted in international reporting surveys and awards schemes.

Companies were invited to submit their corporate sustainability website, their report, or both for consideration. By the end of the submission period, we had received 351 reports (either in the form of printed reports or corporate sustainability websites) in total.

Pre-selection

Once the submission deadline had passed, each report was assessed by SustainAbility's benchmarking team using the seven criteria listed in Figure 06. These criteria helped to narrow the field of submitted reports down to 202. These were then given to our independent Selection Committee to choose the Top 50 and Other 50.

Selection

The final selection was the responsibility of an international committee of experts (see Figure 07). Using the same questions that had guided the pre-selection, the final 50 were identified. It was no easy task for the Selection Committee, and the panellists did not always agree. A few reports made the final cut over the objections of one or more dissenting panellists, and various reports failed to make it into the Top 50 even though one or more panellists continued to champion their cause.

In addition to the criteria listed above, the Selection Committee suggested an eighth, *credibility*. The question was: Would a reasonably well-informed reader find the right issues and concerns presented in the report in a balanced way? This was in response to the concern that a company's report might cover a wide range of issues but perhaps not the most important ones (such as convenience foods and obesity, or automobiles and climate change). This discussion led to some healthy debate during both the selection and subsequent benchmarking processes.



06 Criteria for Report Selection

1 Does the report include elements of environmental, social and economic reporting?
2 Does the company present a coherent vision of sustainability?
3 Are the company's key sustainability challenges clearly stated and prioritised?
4 Is the company's sustainability strategy clear?
5 Is there a balance to the environmental, social and economic performance data presented?
6 Does this report represent innovation in a particular area of reporting?
7 Does the report use various forms of assurance, including stakeholder comments, verification and other external reviews?

The consensus of the selection panel — and of the benchmarking team — is that these reports represent an exciting sample of international best practice that will serve to advance the field of sustainability reporting globally.

Benchmarking

Although the Global Reporters methodology has evolved over the years, benchmarking 50 reports is still a time- and brainpower-intensive task. As reports have improved in quality, the time required for benchmarking has inevitably increased. On average, it now takes a well-trained analyst between two and three days to complete a benchmark for a single company's report and website. Much depends, though, on the report's design. One analyst compared the experience of benchmarking two reports: GM's report, while long, was structured so that it was very quick to benchmark; Carrefour's report, while shorter, was much harder to access and analyse.

The 2004 benchmarking process followed four key steps:

1 Reading In-depth review of the report and material on websites
2 Analysis and scoring Scoring of reports against 48 individual criteria
3 Quality control Peer review of the analysis
4 Finalisation Updating scores and collating data.

We enlisted the help of five external analysts to carry out the benchmarking of our reports. Each analyst was given intensive training on the history and mechanics of the methodology. They worked closely with each other and with members of the SustainAbility core team.

Methodology

As already mentioned, our methodology has evolved as reporting itself has evolved. Following our 2002 survey, for example, we received some extremely useful feedback on our report assessment methodology — including some criticism — which we have begun to address this year. To help us think through the current challenges presented by the methodology and benchmarking process, we also invited 2002's 'Magnificent Seven' companies[26] to meet, share views and discuss proposed changes. Their insights were hugely helpful.

Probably our biggest challenge with the 2004 benchmark survey involved addressing the issue of materiality, whose absence in our 2002 survey was the subject of some criticism. We go into this issue in detail on pages 33–37. As yet, we have not developed a wholly acceptable way to recognise materiality in our scoring, but we do feel that this year's benchmarking process illuminates both the issues and likely future trajectories. We welcome companies' many attempts to explore the issue and strongly encourage further discussion of our approach.

Broadly, however, the comments received during and after the development of our 2002 methodology were supportive.
As a result, the 2004 methodology remains mostly unchanged from the one used in 2002. We have fine-tuned it by adding, removing or merging criteria in ways that respond to identified needs or external feedback received. We believe that these adjustments do not invalidate attempts to compare year-on-year changes.

Overall, the methodology comprises four distinct sections, containing 48 criteria:

Context & Commitments
How the company describes its business, key sustainability issues and challenges, view of the future and commitment to sustainable development.

Management Quality
The processes in place by which the company carries out its stated commitments.

Performance
Description of the company's historic performance against key economic, social and environmental factors:

— Economic Performance
An organisation's impact on the economy generally and specific stakeholders; including, for example, governments, employees and local communities.

— Social and Ethical Performance
An organisation's impact on society generally and specific issues; including, for example, health and safety, human rights and diversity.

— Environmental Performance
An organisation's impact on the environment; including, for example, water use, air emissions and biodiversity.

— Multi-dimensional Performance
An organisation's performance on issues that cover a combination of economic, environmental and social impacts; includes, for example, product impacts, compliance, fines and liabilities, and social and environmental reporting.

Accessibility & Assurance
The methods used to ensure that the information reported is understandable, accurate and credible.

The full methodology is available on our website: www.sustainability.com/risk-opportunity.[27] As always, we welcome feedback, advice and perspectives on how we can improve this increasingly complex evaluation process for future rounds of the survey.

07 2004 Selection Committee

Stanislas Dupré
Utopies
France

Toshihiko Goto
Environmental Auditing Research Group
Japan

Debra Hall
CERES
USA

Jonathan Hanks
University of Cape Town
South Africa

Cornis van der Lugt
UNEP
France
Kenya

Nick Robins
Henderson Global Investors
UK

[26] In alphabetical order, BAA, BP, BT Group, The Co-operative Bank, Novo Nordisk, Rio Tinto and Royal Dutch / Shell Group.
[27] The SustainAbility report assessment methodology is made available to increase understanding and improve the report assessment process, and may not be used for any commercial purpose without the express written consent of SustainAbility Ltd/Inc.

Global Reporters 2004

4

We introduce the Top 50 group of best practice reporters and briefly review progress among The Other 50 reporters.

The Top 50

The most striking feature of the 2004 results is that just over half (26) of the Top 50 are new to our survey. The full Top 50 results are shown in Figure 08 including which companies are included in the Top 50 for the first time. Our Selection Committee's choice of so many newcomers reflects the very high level of sophistication apparent across the board, as well as new and innovative approaches. While those companies that have slipped from the Top 50 are in most cases still publishing high-quality reports and in many cases even improving, they are not generally improving as quickly as others, leaving newcomers to jump the queue and take their places in the Top 50.

The other striking feature is the significant increase in Top 50 reporting scores, including the first score in excess of 70%. In terms of overall rankings, 8 companies that featured in 2002's Top 50 have improved their ranking, though it is worth noting that 11 have fallen, 13 places on average.

With European companies continuing to perform well in the rankings, it is also interesting to note that both environmental and economic reporting continue to evolve strongly — but the dimension that has shown most progress is social reporting.

Early attempts at integrated reporting across multiple dimensions are patchy, leading one of our analysts to talk in terms of 'Frankenstein's Monsters'. We take a look at this area in Figure 32.

Rising Scores: CFS Breaks Through 70% Ceiling

The overall average report score of the Top 50 has risen to 50%, an increase of 7% relative to 2002 (42%) and 2000 (43%). Another encouraging reflection of overall improvement is the number of reports breaking the 50% mark this time round (Figure 09). In 2004, 42% of the Top 50 reports did so, compared with 14% in both 2002 and 2000. Strikingly, too, and for the first time since the Global Reporters benchmark surveys began, we have one company, Co-operative Financial Services, (CFS) breaking the 70% mark.

It is worth noting that criteria in the benchmark have reduced in number by 1, from 49 to 48. This change may have a very small impact on the percentage scores companies achieve.

Europe Back in the Lead

While our sample size constrains our ability to analyse differences in the quality of reporting by geographic region, reporting by European companies outperforms that of other regions, with 7 of the top 10 reporters based in the UK.

[28] Industry groups are based on the Global Industry Classification Standard (GICS®). Effective after the close on 30 April 2003, the Global Industry Classification Standard consists of ten economic sectors aggregated from 24 industry groups, 62 industries and 132 sub-industries.

[29] These ratings were in effect as of end of close 23 September 2004. For more information on Standard & Poor's credit rating refer to Standard & Poor's Criteria Topics: Corporate Ratings Criteria, 2001. Long-term credit ratings are divided into several categories ranging from 'AAA', reflecting the strongest credit quality, to 'D', reflecting the lowest. Long-term ratings from 'AA' to 'CCC' may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories.

[30] For a small number of companies in the Top 50 credit ratings were not available.

08 The 2004 Top 50 Companies

	Company	Country	Industry Group[28]	S&P[29] Credit Rating	Report Year	Score 2002 %	Score 2004 %	Rank 2002	Rank 2004
	Co-operative Financial Services	UK	Diversified Financials	n/a[30]	2003	61	71	1	1
	Novo Nordisk	Denmark	Pharma & Biotech	A-	2003	60	69	2	2
	BP	UK	Energy	AA+	2003	53	66	7	3
New	British American Tobacco	UK	Food, Drink & Tobacco	BBB+	2002/3	—	64	—	4
	BT Group	UK	Telecom Services	A-	2004	58	64	4	4
	BAA	UK	Transportation	A+	2003/4	59	63	3	6
New	Rabobank	Netherlands	Diversified Financials	AAA	2002	—	61	—	7
	Rio Tinto	UK/Australia	Materials	A+	2003	55	60	5	8
	Royal Dutch/Shell Group	UK/Netherlands	Energy	AA+	2003	53	60	6	8
New	HP	USA	Technology Equipment	A-	2004	—	59	—	10
	Unilever	UK/Netherlands	Food Staples & Retailing	A+	2003	38	59	32	10
New	Anglo American	UK	Materials	A-	2003	—	58	—	12
New	Statoil	Norway	Energy	A	2003	—	55	—	13
	Kesko	Finland	Food Staples & Retailing	n/a	2003	39	54	30	14
	Manaaki Whenua	New Zealand	Services & Supplies	n/a	2003	41	52	22	15
New	Natura	Brazil	Household Products	n/a	2002	—	51	—	16
New	BHP Billiton	Australia	Materials	A+	2003	—	51	—	16
	United Utilities	UK	Utilities	A-	2003	42	51	20	16
New	Veolia Environnement	France	Utilities	BBB+	2003	—	51	—	16
New	Ford Motor Company	USA	Automobiles	BBB-	2002	—	51	—	16
New	Lafarge	France	Materials	BBB	2003	—	50	—	21
	Bristol-Myers Squibb	USA	Pharma & Biotech	A+	2003	49	49	8	22
	SABMiller	UK	Food, Drink & Tobacco	BBB+	2004	48	49	9	22
	Volkswagen	Germany	Automobiles	A-	2003/4	48	49	12	22
New	KarstadtQuelle	Germany	Retailing	BBB	2003	—	48	—	25
New	MTN Group	South Africa	Telecom Services	n/a	2003	—	48	—	25
	RWE Group	Germany	Utilities	A+	2003	37	48	34	25
New	Sasol	South Africa	Energy	BBB	2000-2	—	48	—	25
New	Diageo	UK	Food, Drink & Tobacco	A	2003	—	47	—	29
	Novartis	Switzerland	Pharma & Biotech	AAA	2003	39	47	31	29
	adidas-Salomon	Germany	Consumer & Apparel	n/a	2003	29	47	50	29
	General Motors	USA	Automobiles	BBB	2003	40	47	29	29
New	ING Group	Netherlands	Diversified Financials	A+	2002	—	47	—	29
New	Cadbury Schweppes	UK	Food, Drink & Tobacco	BBB	2004	—	46	—	34
	Matsushita Electric Group	Japan	Consumer & Apparel	A+	2003	41	46	22	34
	Chiquita Brands International	USA	Food, Drink & Tobacco	B+	2002	43	45	18	36
New	Suncor	Canada	Energy	A-	2003	—	45	—	37
New	Total	France	Energy	AA	2003	—	44	—	38
New	Daiwa Securities	Japan	Financial Services	n/a	2003	—	43	—	39
New	Philips	Netherlands	Consumer & Apparel	BBB+	2003	—	43	—	39
	British Airways	UK	Transportation	BB-	2002/3	41	43	26	39
	Baxter	USA	Health Care	A-	2002	45	42	15	42
New	Carrefour	France	Food Staples & Retailing	A+	2003	—	42	—	42
New	Starbucks Coffee Company	USA	Food Staples & Retailing	n/a	2003	—	42	—	42
	Sony	Japan	Consumer & Apparel	A+	2003	34	41	45	45
	Deutsche Telekom	Germany	Telecom Services	BBB+	2003	37	41	26	45
New	Ito Yokado	Japan	Food Staples & Retailing	AA	2003	—	40	—	47
New	Barclays	UK	Diversified Financials	AA	2003	—	39	—	48
New	Premier Oil	UK	Energy	n/a	2002	—	39	—	48
New	Gap	USA	Consumer & Apparel	BB+	2003	—	39	—	48

09 The Top 50 Reports

Score %	2000 Survey	2002 Survey	2004 Survey
70–100			1
60–70		2	8
50–60	7	5	12
40–50	23	20	26
30–40	18	22	3
00–30	2	1	

It is particularly exciting to see a Brazilian company breaking the 50% barrier.

17 of the companies breaking through the 50% mark are headquartered in Europe, compared with just 2 in North America, and 1 each from Australia, New Zealand and Brazil.

In 2002, by contrast, we had noted that North American reporters were leading by a hair. Most significantly, perhaps, 17 of the companies breaking through the 50% mark are headquartered in Europe, compared with just 2 in North America, and 1 each from Australia, New Zealand and Brazil.

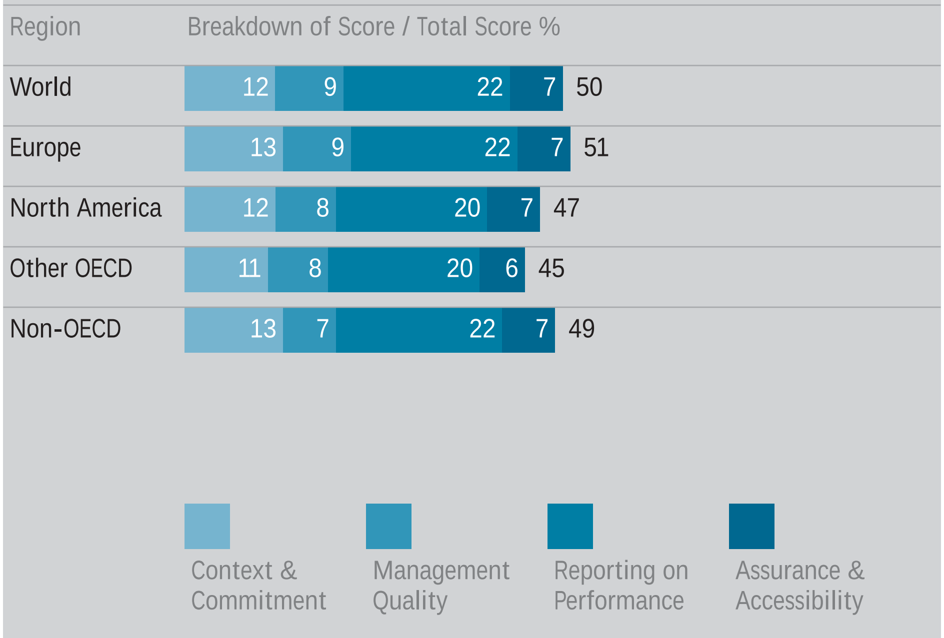
Movers and Shakers: France and Brazil

Anyone who believes that legislation dulls the reporting spirit should take a look at France. New French legislation, in the form of *les Nouvelles Régulations Economiques* (2001),[31] has imposed mandatory reporting on all companies listed on the Paris Stock Exchange,[32] significantly boosting the quality of reporting there. Although a recent survey[33] reported that only a quarter of the companies surveyed were providing at least half of the indicators requested by the law, there was no company providing them all.

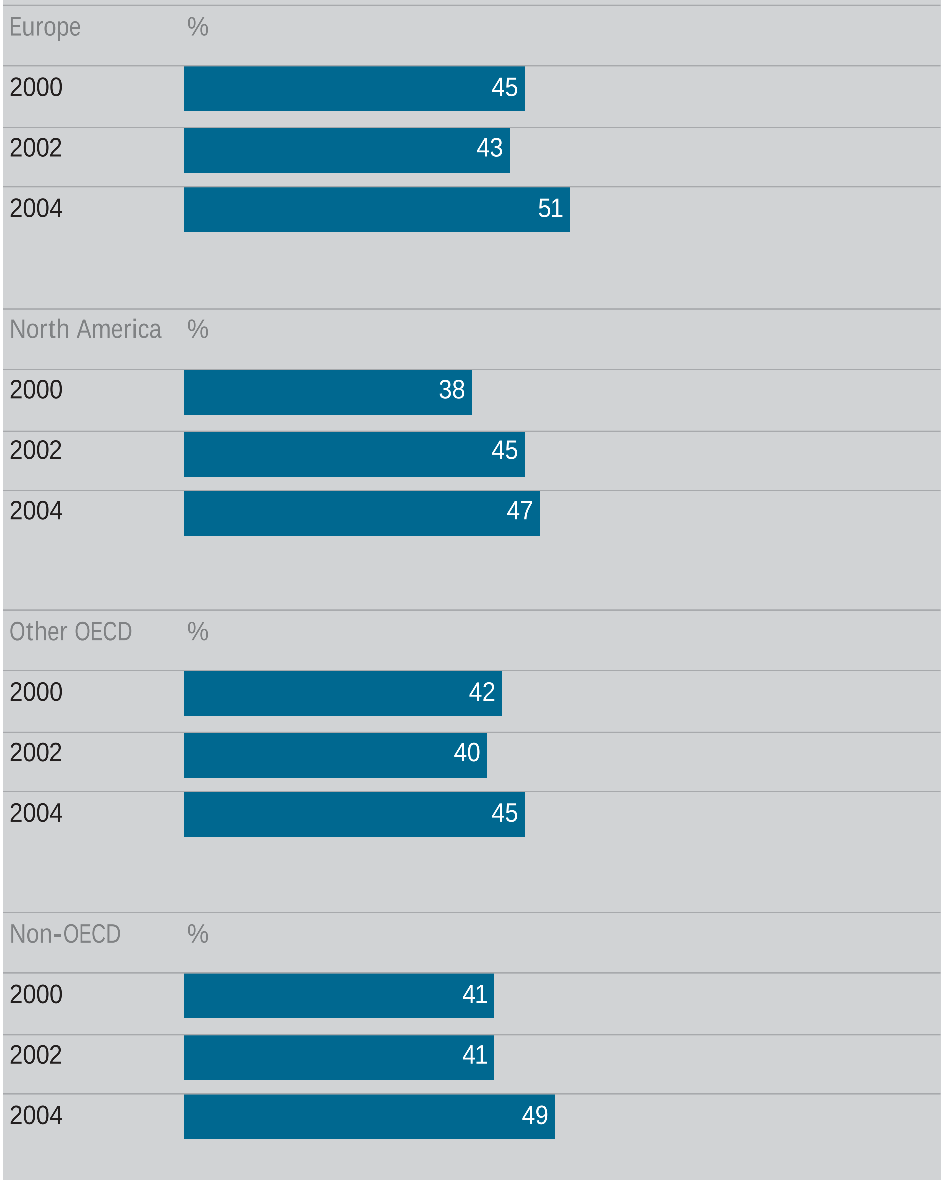
In 2002, we had two French reporters, while in 2004 there are four. Veolia Environnement (51%), Lafarge (50%), Carrefour (42%) and Total (44%) are all newcomers to this survey, and all score well. This is a striking trend, given the country's slow start. Other late starters in reporting should take heart: most of these companies have only recently begun triple bottom line reporting.

Reporting in the 'emerging economies' category is also on the increase with reports from Brazil and South African in our Top 50. It is particularly exciting to see a Brazilian company breaking the 50% barrier. Natura, Brazil's leading 'natural' cosmetics company, scores 51%, alongside long-time reporters like Ford and United Utilities.

10 Performance By Region



11 Average Scores By Region



31 www.admi.net/jo/20020221/JUSC0220073D.html

32 www.euronext.com

33 Utopies, SustainAbility & UNEP, *État du reporting 2003 sur le développement durable*. Version française de l'étude Global Reporters SustainAbility & PNUE, 2004.

The GRI Rules the Roost

In 2002, we found a 60:40 ratio in GRI to non-GRI companies. This year, by contrast, the GRI is the only show in town. In the Top 50, 47 (94%) of the reports are openly using the GRI, of which 12 (24%) are reporting 'In Accordance' with the GRI (Figure 12 & page 38). Among the 'Other 50', 7 (14%) report In Accordance with GRI while, overall, 45 (90%) referred to the GRI in some way or other.

Honey, I Shrunk the Text!

One result of the growing concern about 'carpet-bombing' [34] reports has been an effort on the part of many reporters to rein in the size of their publications. On average, printed sustainability reports covered in our 2004 survey weighed in at a fairly hefty average of 72 pages, but slightly down from the super-size proportions recorded in 2002 (an 86-page average).

Like well-seasoned travellers with their baggage, many of our top reporters are becoming more adept at squeezing more data into the same number of pages.

Just pick up the reports of Co-operative Financial Services, Novo Nordisk or BP, for example, and even a cursory look will show that both the white space and the text size have been crunched, leaving some of our benchmarkers blinking and cross-eyed. A large majority of companies (72%) are using detailed GRI index tables to help readers navigate their reports, with companies such as Barclays and HP leading the way.

But data-lovers will be relieved to hear that the carpet-bombing goes on in a different realm, the internet. Most printed reports are now backed by websites, some of them voluminous to the point where our analysts sometimes wondered whether they mightn't be about to become too vast, equivalent to corporate 'black holes' — with virtually infinite gravitational conditions from which data-hunters would find no escape.

More seriously, the breadth and depth of reporting on the web has now grown to such an extent that it is making the job of analysing and benchmarking printed reports extremely problematic. Through numerous links, a company's sustainability activities are being spun into intricate webs. In some cases, the effect — intended or not — is to give the impression that a company is doing much more than it actually is.

Triple Bottom Line Scorecard

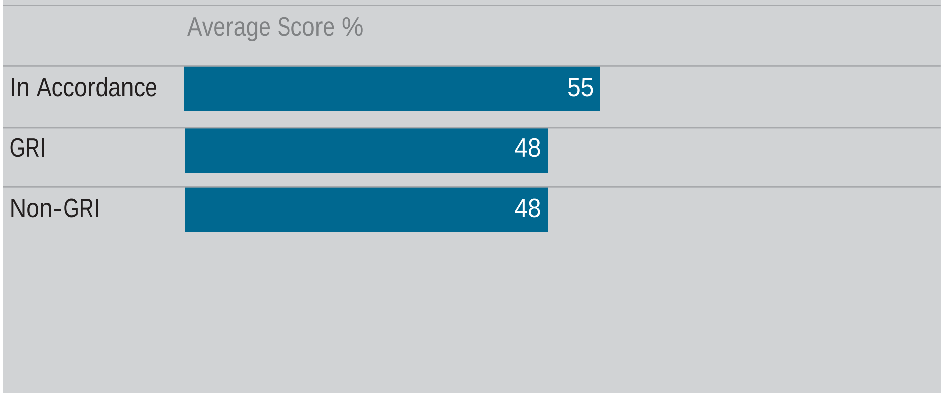
Our 2004 analysis of each of the seven major categories of reporting criteria is outlined in the Performance Scorecards in Figures 13—19. In 2002, we found that companies were rocketing up the social performance learning curve, a trend that continues in 2004 with an impressive 19% improvement in scores in this category.

Context & Commitments

While not the section showing the biggest improvement, there are signs in the 2004 Top 50 reports that companies are beginning to report more openly about what they see as their sustainability challenges. BP is the top scorer in this category. And, as part of their efforts to address the corporate governance agenda, growing numbers of companies are describing the values and principles that drive and inform their CR commitments and performance.

A key step in this process, and one repeatedly stressed in previous editions of this survey, is issue identification. While this area is still relatively weak, companies are beginning to be more systematic in identifying and prioritising their key environmental, social and economic impacts. Co-operative Financial Services is probably the best example of such reporting, clearly identifying each issue and providing useful contextual information on why it is considered a priority. We explore the interplay between issue identification and materiality on pages 33—37.

12 Use of GRI by Reporters in the Top 50



Management Quality

BAA leads the way with outstanding reporting on its systems in place to manage its environment, social and economic issues, while HP takes its report one step further by providing detailed discussion of its role in the ICT industry and its activities to improve its performance.

Corporate governance emerges as one of the defining issues of 2004's Top 50 (pages 10—16). And, perhaps not surprisingly, there have been some major improvements in the quality of reporting in this area. BHP Billiton provides a considerable range of detail on its Health Safety and Environment Committee's governance structures and roles, as well as the most detailed account of its progress against the UN Global Compact Principles of the survey.

As predicted in our 2002 survey, reporting on supply chain management has also become another major hotspot of activity. Companies such as adidas-Salomon, Chiquita, Gap, BT and Starbucks are vying for leadership in this area.

A particularly sensitive area is company lobbying and political activity. This is an issue that has been raised with increasing frequency in recent years, with the result that we are beginning to see companies opening up their thinking and positions on key issues and their associated political activity. While Lafarge is selective in the issues it addresses it does discuss its public policy activities in relation to climate change. The global cement company's declared stance may not be to everyone's liking, but at least it is clear what it is.

A particularly sensitive area is company lobbying and political activity.

[34] See SustainAbility & UNEP, *Trust Us*, 2002.

13 Context & Commitments

Category	Total Score % / Change in Score 2002—2004 %	
Average Score	57	+9
Highest Score	80	0
Lowest Score	35	+7

Top Scores	Total Score %
BP	80
Novo Nordisk	78
BAA	78
CFS	75
Rio Tinto	75
Rabobank	75

CFS Co-operative Financial Services

14 Management Quality

Category	Total Score % / Change in Score 2002—2004 %	
Average Score	48	+7
Highest Score	83	+14
Lowest Score	28	+9

Top Scores	Total Score %
BAA	83
HP	72
Novo Nordisk	69
Rabobank	69
BAT	67
CFS	67

BAT British American Tobacco
CFS Co-operative Financial Services

15 Economic Performance

Category	Total Score % / Change in Score 2002—2004 %	
Average Score	47	+10
Highest Score	71	0
Lowest Score	21	+13

Top Scores	Total Score %
Kesko	71
Novartis	71
Natura	67
BT Group	69
CFS	63
Rabobank	63
Rio Tinto	63

CFS Co-operative Financial Services

16 Social & Ethical Performance

Category	Total Score % / Change 2002—2004 %	
Average Score	50	+19
Highest Score	82	+15
Lowest Score	21	+21

Top Scores	Total Score %
Rabobank	82
BT Group	75
CFS	71
BAT	71
Novo Nordisk	71

BAT British American Tobacco
CFS Co-operative Financial Services

Reporting on Economic Performance

Reporting seems to be gaining traction in the relatively uncharted terrain of wider economic issues and performance (Figure 15), particularly among European companies. Top-scoring food retailer Kesko goes to great lengths to detail the economic benefits the 20 different regions it operates in receive, including real estate taxes and purchasing through its supply chain. Novartis' integrated annual and sustainability report sits its financial performance alongside its programs on access to medicines, providing a sense of scale of the programs.

It is pleasing to see the majority of oil & gas companies in our 2004 sample reporting — to varying degrees — in line with the UK Extractive Industries Transparency Initiative.[35] Anglo American emerges as the best of the bunch in this category stating payments to governments alongside summaries of each of its operations across the globe. Reading the small print, Anglo American also notes that the figures are likely to be underestimates.

Another reason for the increase in scores in this area is the growing attention that investors are enjoying in company reports. As the size of socially responsible investment (SRI) funds grows, alongside the increased interest of some major mainstream investors in critical CR issues, leading companies have responded with more detailed reporting on share performance, SRI ratings and, in the case of Lafarge, the three questions asked by shareholders at the 2003 Annual General Meeting.

Reporting on Social & Ethical Performance

Social and ethical reporting emerges as the big winner in this year's benchmark (Figure 16), with an average 19% improvement since the 2002 survey and an even more impressive 21% gain in lowest score. A newcomer to this benchmark, Rabobank emerges as the top scorer in this category. The report introduces SD implications and characteristics of each of its products, giving details on why the product was introduced, including public policy issues associated with the SD issue the product is tailored to meet.

A controversial top performer here is likely to be BAT (British American Tobacco). While many would dispute its inclusion in this list because of the nature of its business and products, the company's reporting on human rights and community development is world class.

Reporting on Environmental Performance

In the 2002 survey, we interpreted a falling score for environmental performance reporting (2002 scores dropped 9% against 2000) as an indication of waning corporate interest. The results of the 2004 survey (Figure 17), however, suggest a somewhat different analysis. We now see more and more companies reporting on what they consider to be their most important environmental impacts, and leaving out reporting in detail on less critical issues.

One indicator of this trend is the number of companies (21) scoring 4 on our methodology for certain environmental criteria, suggesting full integration in the reporting company's management of the issue and its core decision-making.

[35] The Extractive Industries Transparency Initiative was announced by UK Prime Minister Tony Blair at the World Summit on Sustainable Development in Johannesburg, September 2002. Its aim is to increase transparency over payments by companies to governments and government-linked entities, as well as transparency over revenues by those host country governments. www2.dfid.gov.uk/news/files/extractiveindustries.asp

17 Environmental Performance

Category	Total Score %	Change 2002—2004 %
Average Score	47	+1
Highest Score	89	+11
Lowest Score	7	-18

Top Scores	Total Score %
Unilever	89
BP	86
CFS	68
Rio Tinto	68
BAA	64
Novo Nordisk	64

CFS Co-operative Financial Services

18 Multi-Dimensional Performance

Category	Total Score %	Change 2002—2004 %
Average Score	36	0
Highest Score	67	-8
Lowest Score	0	

Top Scores	Total Score %
CFS	67
HP	67
Novo Nordisk	67
Baxter	58
Unilever	58

CFS Co-operative Financial Services

19 Accessibility & Assurance

Category	Total Score %	Change 2002—2004 %
Average Score	56	+6
Highest Score	83	0
Lowest Score	29	+4

Top Scores	Total Score %
CFS	83
Shell	79
BT Group	75
United Utilities	75

CFS — Co-operative Financial Services
Shell — Royal Dutch / Shell Group

Of our leaders, Unilever achieves the top score in this category. Particularly notable is its reporting on water and materials, while BP displays considerable expertise in interpreting its impact on global CO_2 emissions at a corporate, national, site and, for the first time, product level. Climate change is now a dominant concern for many of our leading reporters, reflecting continuing pressures in this area. A number of companies scored full marks for their reporting on climate change: BAA, BP, Bristol-Myers Squibb, Ford, Rio Tinto, RWE, Total, Unilever, United Utilities, Veolia and Volkswagen.

Reporting on Multi-dimensional Performance

Most companies are still reluctant to provide a core set of accounts of their environmental and social impacts, apart from Novo Nordisk — which offers detailed environmental and social accounts. While not in among the high scorers, Matsushita Electric Group carries on the Japanese tradition of providing detailed environmental accounting, this time integrated throughout its report — instead of the more usual (and somewhat boring) table of numbers in the report's appendix.

Where the 2004 crop of reports gains significant ground in this category is in relation to the impacts of their products. Two financial reporters, Co-operative Financial Services and Rabobank, clearly link their products and services to specific social issues and impacts. Although reporting may not yet meet all relevant stakeholder needs, we now see high profile companies tackling the impacts of their products on climate change (BP), health and nutrition (Unilever) and alcohol responsibility (SABMiller) in considerable detail.

Performance Scorecards — Accessibility & Assurance

Assurance has emerged as a critical area in reporting, in terms of the very different methodologies used, and in terms of the cost-benefit balance. As predicted in 2002, assurance and verification has become big business for reporters and their auditors, though there is great controversy surrounding which forms of assurance add most value. This is an area we explore in greater depth in Chapter 5 (pages 32—35).

Of the 2004 Top 50 reports 39 (78%) include some form of external assurance or review, and the number of companies including in-depth assurance statements has grown substantially. The GRI guidelines (see pages 38—42) feature heavily in the majority of reports, with substantial effort given to indexing each indicator to pages in the relevant report. Our Top 5 scorers in this category are all GRI 'In Accordance' reporters.

> We now see high profile companies tackling the impacts of their products on climate change (BP), health and nutrition (Unilever) and alcohol responsibility (SABMiller) in considerable detail.

Virtual Reporting

It's extraordinary to think that in 1994, when we began our report benchmark surveys, the internet was still a novelty to most people — and the explosive growth in corporate reporting over the web had not begun. When it did, many expected virtual reporting to render printed reports extinct. Not so. For those interested, this is an area we explored in our 1999 survey, *The Internet Reporting Report*.[36]

Most of our 2004 reporters (both Top 50 and Other 50) now supplement their reporting by using their corporate internet sites, some more energetically than others. Good examples of closely integrated print and web-based reporting include BP, HP and Shell. Of the Top 50, only 12% were solely web-based reports, of which BAA, BT, Rio Tinto and Unilever scored best.

It seems that paper-based reporting has still got life, with many companies heavily gearing their printed reports for addressing key issues and concerns, leaving the web to hold the flesh and bones of their sustainability performance. This caused some serious confusion and frustration for our analysts.

The Other 50

Selecting 50 reports for benchmarking proved a difficult task for our Selection Committee (page 17). It may be a surprise to some — and it will surely be a disappointment to others — that some of the longer established reporters have slipped out of the Top 50 — but still remain in the Top 100 — and should be considered examples of best practice. These experienced reporters are still producing strong reports; however, with so many companies now producing reports, competition for slots in the Top 50 is intense.

[36] SustainAbility & UNEP, *The Internet Reporting Report*, 1999.
[37] For some companies in the 'Other 50' credit ratings were not available.

20 The Other 50 Companies

Company	Country	Industry Group	Credit Rating[37]
ABB	Switzerland	Capital Goods	BB+
Abbott Laboratories	USA	Pharma & Biotech	AA
ABN Amro Real	Brazil	Diversified Financials	n/a
AEON Co	Japan	Food & Staples	A-
Agilent	USA	Technology Equipment	BB
Alcan	Canada	Materials	A-
Alcoa	USA	Materials	A-
Allianz Group	Germany	Diversified Financials	AA-
Anglo Platinum	South Africa	Materials	n/a
Aracruz Celulose	Brazil	Materials	BBB-
Autostrade	Italy	Transportation	A
Aventis	France/USA	Pharma & Biotech	A+
BASF	Germany	Materials	AA-
BC Hydro	Canada	Utilities	AA-
BMW Group	Germany	Automobiles	n/a
Camelot Group	UK	Hotels & Leisure	n/a
Canon	Japan	Consumer & Apparel	AA
City West Water	Australia	Utilities	n/a
DaimlerChrysler	Germany	Automobiles	BBB
ENDESA	Spain	Utilities	A
Fuji Xerox	Japan	Technology Equipment	A
Gaz de France	France	Utilities	AA
Grupo Eroski	Spain	Utilities	n/a
Hydro-Quebec	Canada	Utilities	A+
IBM	USA	Technology Equipment	A+
Intel Corporation	USA	Technology Equipment	A+
Melbourne Water	Australia	Utilities	n/a
Merloni Elettrodomestici	Italy	Consumer & Apparel	n/a
Mirant	USA	Utilities	D
mmO2	UK	Telecom Services	BBB
MTR Corporation	Hong Kong	Transport	AA-
Nippon Oil Corporation	Japan	Energy	BBB-
Novozymes	Denmark	Pharma & Biotech	n/a
Old Mutual	UK	Banks	n/a
PotashCorp	Canada	Materials	BBB+
Severn Trent	UK	Utilities	A
Suez	France	Capital Goods	A-
Swiss Re	Switzerland	Diversified Financials	AA
Sydney Water	Australia	Utilities	AAA
Talisman Energy	Canada	Energy	BBB+
Tata Steel	India	Materials	n/a
Telecom Italia	Italy	Telecom Services	BBB+
Tesco	UK	Food & Staples Retailing	A+
The Dow Chemical Company	USA	Materials	A-
Toyota Motor Corporation	Japan	Automobiles	AAA
VanCity	Canada	Banks	n/a
Vodafone Group	UK	Telecom Services	A
Watercare Services	New Zealand	Utility	A+
Westpac	Australia	Banks	AA-
Weyehaeuser Company	USA	Materials	BBB

In the chemical sector, for example, BASF and The Dow Chemical Company may be the world's largest chemical companies, but they no longer represent the cutting edge of reporting.

Our Selection Committee felt that although such companies are still producing excellent reports, they have not yet addressed the key issues of the industry head-on. They are still in defensive mode. That said, it should be noted that BASF and Dow have both made moves to consolidate their reporting, with BASF integrating its annual and sustainability reporting, a move away from its three-volume approach benchmarked in previous surveys, while Dow has focused on internet-based reporting.

Other long-time Top 50 reporters which have dropped into the Other 50 include BMW and DaimlerChrysler. Particularly disappointing is DaimlerChrysler's approach to climate change. The company's 2004 report devotes more space to photographs of handshakes than it does to the discussion of climate change, which is now a key area of risk and opportunity for anyone involved in the mobility business.

European reporters again figure strongly among the Other 50: 20 of the Other 50 are from Europe, with the UK again in the lead, followed closely by Germany and then by France and Italy. North America comes second, with a total of 14 (8 from the USA, 6 from Canada). In Asia, with 7 entries, Japan leads (5), with 1 entry each from India and Hong Kong.

Australia and New Zealand manage a creditable 5, while South Africa — emerging as a fascinating laboratory in terms of corporate accountability, manages 2 entries. Brazil, a member of the BRIC group of countries,[38] also achieves two entries.

Emerging Economy Reporters

The emerging economies countries,[39] represented here by Brazil, India and South Africa, did quite well in 2004, with a total of seven entries in the Top 100, with a Brazilian company and two South African companies in the Top 50 — both Brazil and South Africa achieving two entries in the Other 50. Stand-out features of these reports — and the MTR Corporation report from Hong Kong — included:

— Tata Steel provides one of the strongest reports from emerging economy countries reports and is definitely India's top reporter. It is a bit like a Japanese report with its detailed numerical data, but the report contains an extensive set of stakeholder concerns and issues, linking them with the company's response and strategic objectives.

— From Brazil, ABN Amro Real and Aracruz Celulose both provide excellent accounts of their sustainability performance. ABN Amro Real's report adopts a novel structure, dictated by a customer enquiry about interest rates. The report is shaped around the query, detailing the impacts of its products and services. Aracruz Celulose integrates its annual and sustainability reporting. The forestry and paper products company's detailed reporting on both wealth generation and the allocation of economic resources is world class.

— Anglo Platinum of South Africa very nearly outshines the report from its big brother, Anglo American. Of particular interest is its direct reporting against the requirements of the South African Mining Charter, providing insightful reporting on local development issues and labour rights. Old Mutual South Africa represents the financial services sector, continuing South African reporters' strong history in reporting on corporate governance. Usefully, the report also includes a set of key issues that sit along the bottom of each page. Attached to each is the key indicator and an historical summary of the bank's performance.

— Hong Kong-based MTR Corporation produces what must be the top report series in South East Asia. In line with one of the key themes of *Risk & Opportunity*, MTR produces an insightful table on the company's key risks.

Tata Steel provides one of the strongest reports from emerging economy countries reports and is definitely India's top reporter.

Brokerage firms recommend that corporate managers and board directors 'include social, environmental and governance reporting in their annual reports and financial statements'.

21 Equity Research Analysts Call for Better Disclosure

The pioneers of the socially responsible investment (SRI) movement have shown the way in making the business case for the inclusion of sustainable development and stakeholder interests in company research and valuation. Using shareholder activism, institutional investors are successfully bridging the fields of sustainable development and corporate governance in the long-term interest of their members.

More recently, an impressive number of leading financial services firms — represented through teams of 'sell-side' brokers[40] and analysts — have confirmed the material relevance of governance and sustainable development performance on equity valuation. Companies such as ABN Amro, Deutsche Bank and Goldman Sachs are calling on investors, asset managers and financial markets in general to include these non-traditional aspects in their decision-making.[41]

Regarding reporting and disclosure, these companies make the following observations:

'The majority of analysts noted difficulties in comparative analysis due to the range of reporting practices.'

Jointly, these brokerage firms recommend that corporate managers and board directors 'include social, environmental and governance reporting in their annual reports and financial statements'.

And they encourage governments and regulatory bodies to revise current definitions of fiduciary duty and financial materiality to include sustainability affairs and update disclosure rules accordingly.[42]

In a separate report under the auspices of the UN Global Compact, a similar group of finance organisations considers inclusion of social, environmental and governance aspects to form part of the fiduciary duty for investors, pension fund trustees and others.[43]

They ask companies to 'to take a leadership role by implementing environmental, social and corporate governance principles and policies and provide information and reports on related performance in a more consistent and standardized format. They should identify and communicate key challenges and value drivers . . . Such information is best conveyed to financial markets through normal investor relations channels . . .'[44]

Progress on the implementation of the recommendations of these two reports will be monitored for the UN Global Compact by the UNEP Finance Initiative.

38 BRIC: Brazil, Russia, India, China.
39 SustainAbility and other partners in this project intend to produce a short publication on reporting in the emerging economies.
40 A financial analyst who works for a brokerage firm and whose recommendations are passed on to the brokerage firm's customers.
41 United Nations Environment Programme Finance Initiative (UNEP-FI) Asset Management Working Group (AMWG), *The Materiality of Social, Environmental and Governance Issues to Equity Pricing. 11 sector Studies by Brokerage Analysts*, 2004.
42 Ibid, page 5.
43 UN Global Compact, *Who Cares Wins — Connecting Financial Markets to a Changing World*, 2004.
44 Ibid, page iii.

Assurance & Materiality

5

Assurance and verification were 'Hot Topics' in 2002 and earlier surveys. One new feature of the landscape: materiality. We apply our new Materiality Multiplier to the Top 50, with striking results.

The upward trend in companies using some form of external assurance or review has been relentless, with 39 (78%) of our Top 50 including a discussion of external assurance this year.[45] The decisions companies make in relation to their assurance options signal powerfully how they view their accountability — and the role of their reporting.

We should note here, however, that while the overall trend in the use of assurance has been steadily upward, in some places companies have begun to question the value or utility of the process, even occasionally stepping away from external assurance for a time. The individual experience of assurance is extremely varied, and its role and relevance is still far from clear. Equally, the financial stakes can be high: companies submitting their reports to us for inclusion in the survey consistently note assurance as one of the biggest costs associated with reporting. For a large company, this cost can run into millions of dollars.

The growth in assurance has begun to mirror the growth in reporting, with one notable difference: development of assurance has for the most part been organic, whereas reporting more generally has benefited from the GRI guidelines and other frameworks. Until the AA1000 Assurance Standard was released in 2003, almost no external assurance statements were based on a named standard of any kind — and most still aren't.

This means that it can be very difficult to compare one company to the next in this respect, as one company's 'assurance' may bear little resemblance to another's, even if they operate in the same sector.

What Do We Mean by Assurance?

All this flags up the need for some ground rules. The term assurance is a very broad one. It's best summed up as: 'steps taken to increase confidence in a report'. These steps can be many and various, and no single view prevails as to what must be included in an assurance review, but it often encompasses one or more of the following:

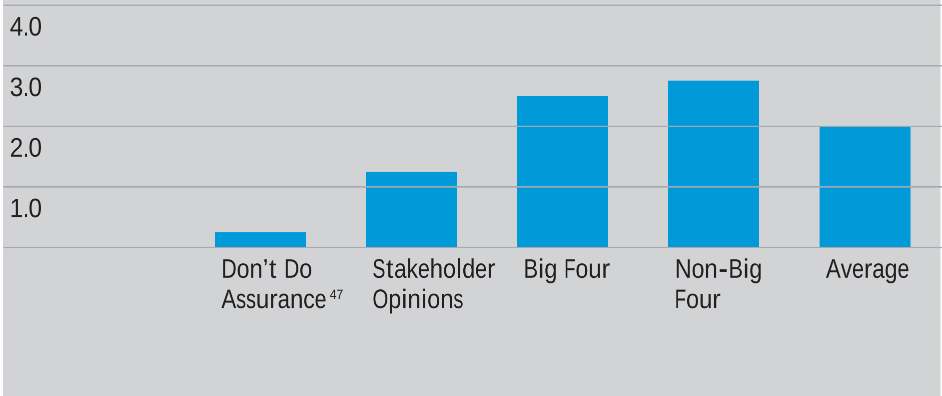
— verification of (specified) reported data
— quality of systems and processes that generate (specified) data
— effectiveness of management systems related to particular issues
— materiality of reported information[46]
— completeness of the sustainability picture on which a report is based
— responsiveness of the company to stakeholders' needs
— stakeholders' opinions on the appropriateness of a company's reporting on an issue.

Each of these provides a different type of assurance to different readers, and they each have a role to play. For the purposes of our benchmarking, we don't evaluate the assurance process as such; we can only evaluate what an assurance statement has to say about that process.

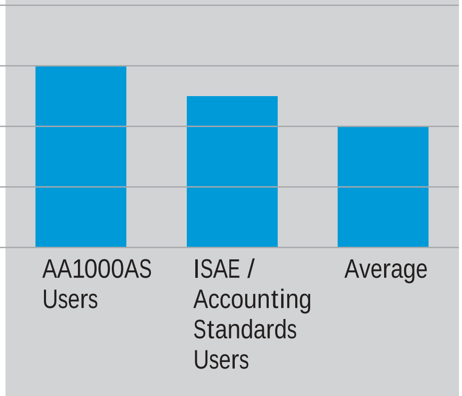
The Playing Field

With respect to the content of assurance statements, there are some real differences between the approaches used by this year's Top 50, and in respect of who's doing them (Figure 22).

22 Average Benchmark Scores for Different Styles of Assurance



23 Use of Assurance Standards



24 Outstanding Examples of Assurance

Company	Assurance Provider(s)	Standard(s) of Reference	Notes
BAA	ERM	AA1000AS, GRI	Very detailed opinion, including reporting and performance against key issues
BP	Ernst & Young	AA1000AS, GRI In Accordance	Very detailed statement, with transparent and specific feedback
BT Group	Lloyd's Register Quality Assurance	AA1000AS, GRI In Accordance, GRI Telecommunications Sector Supplement	Varied approach, presented alongside views of the independent Leadership Panel on BT's strategy and performance
Chiquita Brands International	Rainforest Alliance, COVERCO, Independent Monitoring Group of El Salvador	Rainforest Alliance, SA8000	Multi-faceted approach focusing on specific performance aspects, targeted at the company's most exposed issues
Co-operative Financial Services	JustAssurance	AA1000AS	Specific and straightforward statement, linked closely to expert views on company performance
Novo Nordisk	Deloitte	AA1000AS, ISAE	Review covers reliability of data collection, appropriateness of reporting, GRI 'In Accordance' status. The full management letter and company response are included on website
Premier Oil	Corporate Citizenship Unit, Warwick Business School	AA1000AS	Open and challenging statement, with insight into the progress in implementation of Premier Oil's CSR strategy and programs
Sony	PricewaterhouseCoopers	—	Clear areas for improvement, with interesting discussion of Sony's Global Warming Potential exposure
Suncor	PricewaterhouseCoopers	Standards for Assurance Engagements (CICA)	Identifies key areas for improvement, with clear verification of Suncor's sustainability performance indicators

45 This includes any evidence of a systematic process to assess the quality of reports or data.

46 The principles of Materiality, Completeness and Responsiveness are the basis of the AA1000 Assurance Standard. www.accountability.org.uk/aa1000/default.asp?pageid=52

47 It is worth noting that a few companies not currently engaging in external assurance of their reports nevertheless discuss the issue and, in a few cases, their future plans in this regard.

Of the 39 reports that provide some form of external assurance or review, 16 (41%) make use of one of the Big Four audit and consulting firms (Deloitte, Ernst & Young, KPMG and PricewaterhouseCoopers); four (10%) of statements are provided by stakeholder organisations or experts; and 19 (49%) come from assurance professionals at smaller or boutique firms (such as ERM, JustAssurance and CSR Network).

But the most significant differences come to light when we look at the standards used by assurance providers. The two frameworks in common usage are:

— Accounting Standards
Generally the International Standard on Assurance Engagements issued by the International Auditing and Assurance Standards Board, but also the German IDW PS820 and Canadian CICA Standards for Assurance Engagements

— AA1000 Assurance Standard
Specifically aimed at assurance of sustainability reports

While some assurance statements mention frameworks such as the GRI guidelines or SA8000 standard as a consideration for the review of reports, we do not consider them here, as these are not meant to be used as report assurance standards, and do not provide guidance on assurance of reports.

Things become interesting when we look at the relative scores (Figure 23). Users of the AA1000 Assurance Standard hold a distinct lead over those using the accounting standards, and an even bigger lead over the Top 50 on average. Clearly, AA1000 users are able to provide much more information in their assurance statements than others do, and this significantly raises the value of their statements for readers.

There are also examples of reports using both the AA1000 Assurance Standard and the International Standard on Assurance Engagements, and the result can be powerful: Novo Nordisk, for example, uses this approach (including the company's response posted on its website) and achieves a full 4-point score. Others using this combination of standards include RWE and Rabobank, although in their cases somewhat less effectively.

Given the effort that assurance entails for companies — and the faith many place in it to improve their processes or reputation — we would very much like to be able to evaluate more than assurance statements alone. In the future, it's vital that better information be developed on how different assurance approaches affect cost, and the impact on reputation or credibility. For this to happen, however, companies and their assurance providers will need to lift the lid on their processes.

The Materiality Debate

Materiality has emerged as one of the biggest conceptual challenges for corporate reporters in recent years. And not before time. The pressures on companies to make their reports ever more complex have been growing: 2002, for example, saw the release of a new version of the GRI guidelines, with a considerably expanded indicators section; then there was the drafting of the AA1000 Assurance Standard; and, by no means finally, our own identification of the 'carpet bombing syndrome' struck a chord.

Reports risk becoming cluttered with information of little apparent use to readers, while missing out on the big picture risks and opportunities. Practitioners and readers alike need to find a way to assess what really matters most, and focus effort on those areas.

Like the term *sustainability* itself, *materiality* strikes many people as pretty nebulous, so it's perhaps a bit surprising that it has caught on as well as it has. The definition used nowadays by reporting practitioners comes out of the financial accounting tradition, and goes something like this: *Something is material if it has the potential to affect your perception of the company and any decisions you might take as a result.*[48]

In terms of understanding the basic concept, we've come a long way, but in reality we have made a few small steps in a long journey. As the concept has risen in prominence for sustainability reporters, there have been efforts to find new definitions for materiality that properly capture non-financial issues (see, for example, AccountAbility's report, *Redefining Materiality,*[49] and the *GRI Boundary Protocol* draft[50]). These efforts, however, will not result in anything quite so simple as a list of indicators a company should consider material. That is because materiality requires a process of decision-making in full knowledge of the company context — which is constantly changing.

Material issues are easy to spot in hindsight, especially when something goes wrong at a company. But this is a major problem for anyone wanting to assess future risks and opportunities at a company: you'd need a crystal ball to be able to predict the circumstances under which any particular bit of information becomes key to your assessment; the one thing that could have made the difference comes to light after the fact.

25 Materiality is a journey

26	**Calculating the Materiality Multiplier** Figures shown are for Company X			Original Scoring	Revised Scoring	
Step 1	Benchmark all 4 Sections (48 Criteria) of the report according to the standard Benchmark Methodology	Section I	Context & Commitments	24		
		Section II	Management Quality	31		
		Section III	Reporting on Performance	36		
		Section IV	Accessibility & Assurance	12		
		Total		103		
Step 2	Calculate Materiality Multiplier by averaging Issue Identification scores		Economic Issue Identification	1.00		
			Social Issue Identification	2.00		
			Environmental Issue Identification	3.00		
			Stakeholder Issue Identification	1.00		
			Materiality Multiplier	1.75		
Step 3	Divide all Reporting on Performance Criteria scores by 4		Economic Impact to Employees	4.00	1.00	
			Human Rights	2.00	0.50	
			Water Use	3.00	0.75	
			Product & service impacts	1.00	0.25	
Step 4	Apply Materiality Multiplier to all Reporting on Performance Criteria scores		Economic Impact to Employees		1.75 x 1.00	1.75
			Human Rights		1.75 x 0.50	0.87
			Water Use		1.75 x 0.75	1.31
			Product & Service Impacts		1.75 x 0.25	0.43
Step 5	Calculate revised Reporting on Performance Section score from revised Performance Criteria scores	Section III	Reporting on Performance			18
Step 6	Add revised scores of 4 Sections of Benchmark Methodology to calculate revised total	Section I	Context & Commitments			24
		Section II	Management Quality			31
		Section III	Reporting on Performance			18
		Section IV	Accessibility & Assurance			12
		Total				85
Step 7	Calculate percentage score by dividing revised total score by the total possible score (192)	%				44

[48] For example, the Financial Accounting Standards Board (FASB) *Statement of Financial Accounting Concepts, No. 2, Qualitative Characteristics of Accounting Information* defines materiality as: 'the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgement of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.'

[49] Simon Zadek & Mira Merme, *Redefining Materiality: Practice and Public Policy for Effective Corporate Reporting*, Institute of Social and Ethical AccountAbility, 2004.

[50] www.globalreporting.org/guidelines/protocols/boundaries/BoundariesExposureDraftFinal.pdf

27 Impact of Materiality Multiplier on Top 50

Company	Materiality Multiplier	Original Score %	Revised Score %	Original Rank	Revised Rank
BAA	3.5	63	61	6	1
Novo Nordisk	3.25	68	58	2	2
BT Group	3.25	64	58	4	2
Co-operative Financial Services	2.75	61	53	1	4
BP	3	66	53	3	4
HP	2.75	59	53	10	4
Rabobank	3.25	61	51	7	7
British American Tobacco	3	64	51	4	8
Unilever	3.5	59	50	10	9
United Utilities	2.75	51	49	16	10
Kesko	2.75	54	47	14	11
Manaaki Whenua	2.5	52	47	15	11
Royal Dutch / Shell Group	2.5	60	47	8	11
SABMiller	3	49	46	22	14
Veolia Environnement	2.75	51	44	16	15
Lafarge	2.75	50	43	21	16
BHP Billiton	2.75	51	43	16	16
MTN Group	2.5	48	43	24	16
Rio Tinto	2.25	60	43	8	16
ING Group	2.5	47	43	28	16
Cadbury Schweppes	2.5	48	43	33	16
adidas-Salomon	2.75	47	42	28	22
Anglo American	2.75	58	42	12	22
Diageo	2.75	47	42	28	22
Suncor	2.75	45	42	35	22
RWE Group	2.25	48	42	24	22
Bristol-Myers Squibb	2.25	49	41	22	27
Philips	2	43	41	38	27
Statoil	2.25	55	41	13	27
KarstadtQuelle	2.5	48	41	24	27
Sasol	2.5	48	40	24	31
Ford Motor Company	2.25	51	39	16	32
Volkswagen	2.25	49	39	22	32
Daiwa Securities	2	53	38	38	34
Carrefour	2.25	42	35	41	35
Chiquita Brands International	1.75	45	35	35	35
Total	2.25	45	34	37	37
Natura	1.75	51	33	16	38
Starbucks Coffee Company	1.75	42	33	41	38
Matsushita Electric Group	2	46	33	33	38
British Airways	1.75	43	33	38	38
PremierOil	2	39	32	48	42
Novartis	1.5	47	32	28	42
Ito Yokado	2.25	40	31	47	44
Gap	1.75	39	31	48	44
Sony	1.25	41	30	44	46
General Motors	1.75	47	30	28	46
Barclays	1.75	39	30	48	46
Baxter	1.5	40	28	41	49
DeutscheTelekom	1	41	26	44	50

What is important in such complex situations is not the specific fact or detail that went misreported or unreported, it is the system of internal controls that a company has in place for managing risks on an ongoing basis. Therefore, materiality is not an end state — it is a process, and a governance process at that (page 12).

Benchmarking Materiality

Indeed, materiality may be the single most important governance process at any company. If good corporate governance is about creating the conditions for full accountability, to shareholders as well as other stakeholders, the process by which a company reviews issues and impacts to determine the most important risks and opportunities they present is fundamental.

Because no one has the gift of foresight sufficient to predict how an issue that may not be top of mind might threaten the very foundations of a major company, we need to rely on the robustness and transparency of that process. If we can understand and trust the issue identification and prioritisation process, we can assess whether a company's report is sufficiently informed by it.

This is the focus of our benchmarking when it comes to understanding materiality. We think a reader's ability to judge how a company's leadership assesses material risks and opportunities is captured by the following cluster of criteria:
— economic issue identification
— social issue identification
— environmental issue identification
— stakeholder involvement in issue identification and prioritisation.[51]

If reporting on these four areas is robust, readers will be well equipped to judge for themselves the quality of the company's issue identification as a governance function — whether or not they agree with the way the company prioritises risks as a result.

Even in the financial accounting field, where materiality has been a recognised issue for decades, there is no simple answer to the question, what is material? In fact, to the extent that financial accountants have attempted to address the issue at all, it has been through relatively crude rules of thumb.

Because financial accountants don't have any simple, consistent tool for assessing materiality based on issues and share-holders' opinions, they tend to designate a financial threshold — perhaps 3% or 5% of revenues — below which things are not considered financially material. This is not because they are in fact not material (in that they do not have the potential to affect investors' opinions of the company), it is simply because that's the only way an accountant can easily exclude issues without actually having to spend a lot of time thinking about them.

The Materiality Multiplier

We wanted to know how the Top 50 would fare if the quality of issue identification could fundamentally alter their scores. So we conducted an experiment of our own, using a device we call the 'Materiality Multiplier'.

The idea is that reports should only score well on reporting their performance impacts if they have demonstrated through good issue identification that these impacts are important (indeed, material).

Step 1
The report is benchmarked as normal.

Step 2
The Materiality Multiplier is derived by calculating the average scores on the issue identification criteria in Section I — Context & Commitments of the benchmark methodology.

Step 3
The scoring scale is revised for all criteria in the Reporting on Performance Section — usually 0/1/2/3/4 points — down to 0.25/0.50/0.75/1.00 points, by dividing the report's score for each criterion by 4. This means scores are kept within the 0 to 4 points range when the Materiality Multiplier is applied.

Step 4
Each of the revised scores in the Reporting on Performance Section is multiplied by the Materiality Multiplier calculated in Step 2.

Step 5
The new total for the Reporting on Performance Section is summed.

Step 6
Using the scores taken from the initial benchmark, the total scores for the outstanding three Sections (Context & Commitments, Management Quality, and Accessibility & Assurance) are added to the new revised score for the Reporting on Performance Section are added together.

Step 7
The new revised benchmark total is divided by the maximum score a company can receive on the methodology (192) to give us the final score in percent.

Using this method, a company can still score a maximum of 4 points on each of the performance reporting criteria, but only if it also scores 4 on each of the issue identification-related criteria. It's by no means perfect — poor results can come from either issue identification or performance reporting, and our tool can't say which it is for certain. To mix our metaphors, it may prove to be a bridge too far, but its application certainly turns up some interesting food for thought.

The most important result of this experiment is that no company's overall score improves as a result (nor can it — the Materiality Multiplier can only revise final scores downward). On average, companies lose 9% from their total scores, notionally wiping out the 10% increase in scores since our 2002 survey.

28 Big Falls, Small Falls

Reports from the following companies all lost at least 15% off their scores using the Materiality Multiplier:

— Anglo American
— Daiwa Securities Group
— Deutsche Telekom
— General Motors
— Natura
— Novartis
— Rio Tinto.

While the reports from these companies lost no more than 3%:

— BAA
— Philips
— SABMiller
— Suncor
— United Utilities.

Movers and Shakers

In terms of our rankings, the Materiality Multiplier certainly reshuffles the pack: CFS is knocked off the top spot by BAA, while high scorers Rio Tinto and Anglo American drop considerably — 8 places and 17% for Rio Tinto, and 10 places and 16% for Anglo American. The biggest loser is Natura, however, with a drop of 22 places and 18%.

But what can we infer from these figures? This is in no way a scientific exercise, and it's still only a very limited tool for judging materiality. But what it does tell us is that the sort of companies that lose the most off their scores are the ones we called 'carpet bombers' in 2002. They report in great detail on a multitude of performance aspects without giving the reader the tools to evaluate them or to evaluate how relevant they are.

[51] Refer to SustainAbility's Global Reporters Sustainability Reporting Assessment Methodology. www.sustainability.com/risk-opportunity

The GRI
A Perspective

6

Virtually all our Top 50 reports use the GRI, in one way or another. So where is the Initiative headed?

The Global Reporting Initiative (GRI) has been catalytic in the rise of sustainability reporting in recent years. The GRI organisation is at a critical moment in its history, with the next 12 months likely to define its future powerfully. The question is: what path will GRI take?

Since our 2002 survey, GRI has steadily continued its progress in developing and encouraging the use of consistent guidelines for sustainability reporting. The number of companies known to use or reference the GRI's sustainability reporting guidelines[52] currently stands at 571,[53] a significant advance from the 140[54] two years ago. Virtually all (47) of the Top 50 make some visible use of the GRI guidelines, including 12 reporting In Accordance with the guidelines.[55]

The role of the GRI — and its guidelines — with respect to this survey is complex. Whereas GRI focuses on broad, general acceptance of sustainability reporting and adherence to consistent methods, *Risk & Opportunity* — like all previous SustainAbility/UNEP surveys — focuses on best practice and innovation in reporting.

The companies showing best practice, as highlighted here, are clearly influenced by the deepening acceptance of sustainability reporting, and the GRI has had a powerful role to play in stimulating this trend. Indeed, the fact that so many companies have stepped forward with high-quality sustainability reports — including many from developing countries — owes much to GRI's tireless efforts.

But when it comes to detailed benchmarking and analysis, a company's reliance on the GRI guidelines does little to differentiate it from others. Drawing this distinction more clearly is, we believe, the chief contribution of our surveys.

Status Check

It's been seven years since the GRI concept first coalesced in Boston, and for many observers that means the honeymoon is over. To secure its place in the corporate accountability hall of fame, the GRI needs to be seen to be delivering on its early promises. The GRI has evolved enormously from its early form. It is no longer a quirky but compelling little campaign: it's an institute with great ambitions to formalise, professionalise and standardise the field of sustainability reporting. It's not yet at the level of a true professional institute, but it's on its way.

From where we stand, GRI has to date enjoyed a degree of success against most of the early goals it set itself, more strongly in some areas than in others. Some of the key points of progress include:

Strong progress

■■■■□

Broaden the appeal of sustainability reporting and the number of companies participating in it.
The rise of the GRI guidelines has coincided with a significant increase in the number of companies providing sustainability reports. GRI's own targets regarding numbers of corporate users of the guidelines (600 reporters by year end 2004) are well on track to being met.

> 'The GRI arose because many different voices — corporate executives, environmental activists, human rights campaigners, investors, and labor leaders, to name just a few — shared the same goal: the creation of a generally accepted standard for the disclosure of sustainability performance. The adoption of the GRI by more than 500 companies, and GRI's current work to bring together thousands of global stakeholders in preparation for the next version, shows that we are moving steadily toward that goal.'
>
> Bob Massie

Moderate progress

Clarify and demonstrate consensus on the broad expectations of company sustainability reports.
Beginning with the earliest version in 1999, the GRI guidelines have steadily gained in clarity and standing as defining a broad consensus on how companies should prepare sustainability reports. It is currently used as a major source of input into the reporting process for hundreds of companies. A serious gap remains, however, in understanding and responding to the challenge of the Reporting Principles included in the guidelines, in many ways far more ambitious than the report content, but the subject of less focus.[56]

Raise the level of consistency, comparability and generally accepted practice evident in sustainability reporting.
More companies are reporting with somewhat greater consistency — in terms of broad content, and, in some cases, indicators and protocols. But specific comparability remains elusive.

Establish an effective institution to shepherd sustainability reporting into the future.
Since becoming an independent organisation in 2002, GRI has worked hard at setting up its institutional structures, developing a strong business plan and, at the same time, pushing forward the guidelines revision process. Much, however, remains to be accomplished.

Weak progress

Simplify and streamline requests for information about corporate sustainability.
While many of the potential audiences for corporate sustainability reports are increasingly aware and supportive of GRI reporting, specialised questionnaires and requests for information have not, in the main, decreased. However, having said that, recent advances in dialogue with SRI organisations are encouraging in this area.

Expand the use of reports by companies and stakeholders.
We have yet to see real evidence that potential users of GRI reports — including NGOs and most investors — read, understand and use reports regularly to help them with their work. This may be one area where the goalposts have moved over the years: not only does the use of reports require a substantial proportion of the corporate sector to provide them; the landscape is further complicated by the growth of the broader framework of standards, guidelines and codes related to corporate responsibility and sustainability — of which GRI is a part. This framework itself may require clarification in the minds of users before substantial progress can be shown.

The process of institutionalising GRI has been intentional right from the very beginning. In its earlier form, GRI was largely the focus of 'leadership' companies, but the centre of gravity has shifted to reflect the rise of reporting among companies of all types, backgrounds and abilities.

This does not mean that reporting leaders depend any less on the GRI guidelines now than they ever did, but what they get from the guidelines is of a different nature today than it was a few years ago: GRI is now much more a part of the background, the 'wallpaper' of reporting — it's there, we know it's there, but we just don't think about it all that much.

The Invisible Hand

To an extent, this is exactly what GRI had planned all along. Where it once was new and exciting, GRI has become customary and familiar. And this is exactly what's required for GRI to achieve the same level of penetration that financial reporting enjoys today.

However, the GRI's evolution from a highly visible organisation to an increasingly invisible one is not without its problems, and indeed each has its strengths and weaknesses. By seeking deeper linkage to financial accounting and legal requirements, GRI will become more automatic — and reach more companies — but less strategic. If GRI remains the stuff of a few leadership companies' CEO speeches it will be more individualistic — and perhaps more profound for those companies — but less widespread.

Perhaps most significantly, GRI's organisation, governance structure and business model evolved at a time when leadership companies were a more powerful driver of the reporting agenda than they are today, and may need further evolution before they are up to the task of servicing a more embedded professional standards institute. Most of all, GRI needs a diverse range of stable income sources.

52 www.globalreporting.org/guidelines/2002.asp
53 www.globalreporting.org/guidelines/reports/search.asp as at 13 October 04.
54 *Trust Us.*
55 'In Accordance' status requires companies to:
— Report on all numbered elements and indicators in the core guidelines, with either the requested information or an explanation for its absence.
— Ensure the report is consistent with the guidelines' reporting principles.
— include a GRI content index, allowing readers easily to cross-check against the guidelines.
— include a statement from the board or CEO declaring the report to be in accordance with the GRI guidelines, and to represent 'a balanced and reasonable presentation of our organization's economic, social and environmental performance'.
56 The GRI Guidelines include a section on *Reporting Principles*, which are: transparency, inclusiveness, auditability, completeness, relevance, sustainability context, accuracy, neutrality, comparability, clarity and timeliness. General definitions of these principles are provided, but clarity on how they work in practice is, to date, thin on the ground.

At present, there is much reliance on GRI's Organisational Stakeholders (OS). These are GRI's 'members', including companies, NGOs, service providers and others, who pay a modest annual participation fee. In addition, subscription and fee-for-service offerings could provide important revenues. And it is vital that the reporting guidelines themselves attract support to the institution that provides them.

This latter point is a perpetual problem for initiatives that provide a service to many, often referred to in the natural resources area as the 'tragedy of the commons'. If 'everyone' benefits, no one assumes any special responsibility for it. With so many stakeholders participating in and benefiting from the GRI guidelines, no one group has been properly motivated to take ownership for the organisation's financial success:

— Business
  With hundreds of companies using the guidelines and participating in their development, it is tempting to think that 'someone else' has a bigger budget or lower bureaucracy, and a single company's contribution makes no difference.

— NGOs
  Given that NGOs are generally less well heeled than companies, it is tempting to think that those companies should be the ones to fund GRI, not NGOs.

— Governments
  Because sustainability reporting will not benefit any one country more than any other, the specific motivation to provide financial support to GRI can be difficult to create.

— Professional service providers.
  Because there is no fee to use the guidelines, it may be tempting to believe that the guidelines and the process that supports them are 'already paid for'.

If this state of affairs continues, it will raise some pretty fundamental challenges for GRI. For instance, it may be necessary to rethink the guidelines as free to use for everyone. This would be a significant departure from GRI's historical commitment to inclusivity — for small companies, for NGOs, for those in developing countries, just as much as for major multinationals. It could become necessary for GRI to scale back massively on its worldwide engagement activities, in order to keep costs down.

In the most severe scenario, GRI may be forced to consider a merger with another organisation, such as ISO or IASB. Any of these outcomes would be undesirable, as the result would be to undermine the open, accountable structure GRI has innovated. In the worst case, the weakening of the GRI and guidelines that might ensue could herald a return to the bad old days of standard-less, free-for-all reporting — in no one's interest.

For all of these reasons, we believe it is vital to support GRI's efforts — or risk the consequences of failure. But continuing slow progress on the financial front suggests several issues needing careful attention, in particular:

— Some companies have not been convinced by the 'value' of being an Organisational Stakeholder (OS).
  While the specific benefit is to be able to elect a portion of the GRI board, we believe large companies are more interested in the development and positioning of the guidelines. There must be a way to parlay this into an opportunity to increase financial support.

— Certain GRI governance structures need significant attention to help them come up to speed, including the Stakeholder Council and the Technical Advisory Council. In the former example, a better definition of their role, and possibly a more regional basis to their operation, would go a long way. In the latter, which is not yet operational, a clear interplay of roles with other governance bodies needs to be established to enable all parties to participate fully in the next revision to the guideline and build a strong organisation for the long-term.

Additionally, the GRI guidelines are only one piece of the puzzle for companies when it comes to sustainability and accountability to stakeholders — other voluntary initiatives, such as any forthcoming ISO CSR standard, the AA1000 Assurance Standard and specific performance validation (e.g. SA8000 compliance), all add depth to the overall architecture of standards and frameworks. GRI is clearly well positioned to figure strongly in how this overarching accountability framework develops and deepens, and should continue to devote time and energy to making this happen.

For all of these reasons, we believe it is vital to support GRI's efforts — or risk the consequences of failure.

GRI in the Top 50

All this may be interesting background, but what does it add up to? Is the GRI helping to change the way companies think about their impacts and relationships with stakeholders, and creating conditions for accountability? And are GRI-based reports really any better than their non-GRI counterparts?

As we noted earlier, nearly all of the Top 50 are using the GRI guidelines in some way, and this trend has been steady since 2000. Given this, it's difficult to assess any meaningful difference between GRI- and non-GRI-based reports, so instead we focus on those companies reporting 'In Accordance' with the GRI guidelines.

At the time of writing, 41 companies have declared themselves to be reporting In Accordance with the guidelines, including 12 from our Top 50. The difference in scores tends to indicate a moderate advantage for the In Accordance reporters (Figure 29).

But beyond the scores, what difference can we see between In Accordance reporters and the others? Frankly, not a lot, especially in light of the fact that the top 10 include plenty of both. Even the survey's leader, Co-operative Financial Services, is not reporting In Accordance (although at the time of writing, the company was 'working towards' In Accordance status). And several strong reporters appear to be reporting in an 'In Accordance' fashion, but simply not declaring their reports as such (e.g. BAA and Kesko). Moreover, there is no discernible difference between the two in terms of the 'fullness' of the sustainability picture they paint. Why, then, would a company bother?

We put this question to a number of In Accordance reporters in the Top 50, and here's what they had to say:

'We believe supporting a strong, credible international standard, such as the GRI, enables us better to meet the expectations of our stakeholders. Ensuring that we are applying the highest standard available was the basis for our decision to be an In Accordance reporter. It makes you ask the tough questions and requires real internal commitment and alignment on the breadth of issues the GRI covers.'
Dianne Humphries, Suncor

'As part of making our recent switch from "environmental and social" to broader "sustainability" reporting, we decided to report In Accordance with GRI because it made sense to align with a single, international, standardised approach to non-financial reporting. In practice, this made little difference to our planned content, although if we hadn't had external auditors check whether we met the GRI requirements, we'd have felt less comfortable signing off on it. We're keen to promote a good standard of reporting across our industry, and GRI is a good starting point for that.'
Bill Boyle, BP

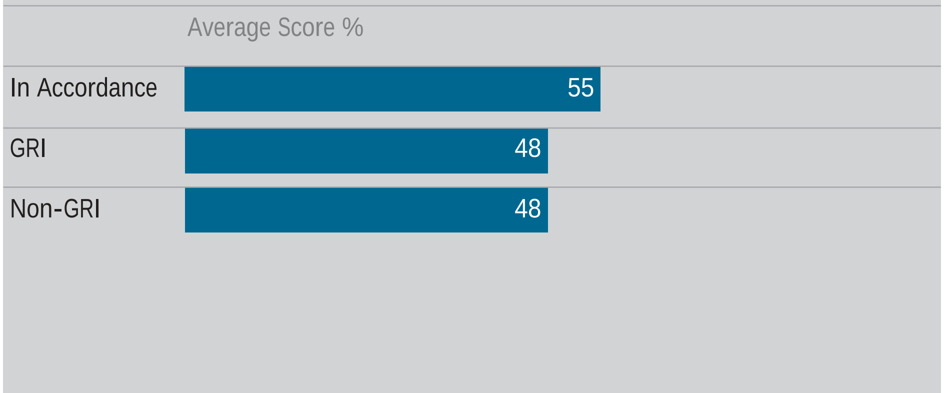
'Before the launch of the current guidelines, we noted in our June 2002 report that when the new guidelines were released later that year, we would report in accordance with them. This was before the GRI had even designated the phrase "In Accordance"! When the guidelines were subsequently published we suddenly found ourselves with a commitment we hadn't expected. We had been long time supporters of GRI and decided it was easier simply to do it than to try to explain what we might have meant by the term "in accordance".'
Chris Tuppen, BT

What this very small sample would tend to tell us is that the reasons for reporting In Accordance are more idiosyncratic than we might have thought. What they share is a general sense of 'support' for GRI as a global, voluntary, common framework for reporting.

There is a certain structural similarity to many of the reports based more obviously on the GRI guidelines, in that section titles and order can be similar between reports. In a few cases, such as Natura, the guidelines come through in an almost question-and-answer fashion. More interesting differences are apparent when you look at the so-called GRI Content Index required of In Accordance reporters.

The way companies treat deviations from the guidelines is often very enlightening. Contrast, for example, Royal Dutch / Shell's GRI content index, including clear symbols representing the extent to which their reporting responds to the guidelines, with that of General Motors, where lapses are more often than not explained with a simple 'not applicable' or, more significantly, 'not required' (pertaining to non-'core' guidelines). In the latter case, this example arguably betrays a mindset rather more concerned with compliance than with accountability.

29 Use of GRI by Reporters in the Top 50



The Best and the Rest

This compliance-versus-accountability split appears to be an emblematic difference between some reporters and others, and in fact indicative of the extent to which they view the guidelines in the 'invisible' or 'visible' paradigm. An invisible GRI is worked into the background fabric of what companies are required to do; a visible GRI is a challenging and inspiring framework for creating innovation and improved accountability.

As the GRI is broadly interpreted by companies at present, it's a great tool to help companies meet basic expectations. It distils the central challenges to an apparently straightforward framework; it builds a certain credibility for a company's approach to sustainability. But it is still up to the individual companies to demonstrate real accountability for understanding and acknowledging their impacts; to develop a full set of competencies to deal with them; and to demonstrate that stakeholders' views really matter. And if what we see among the Top 50 is anything to go by, there are massive differences between companies' approaches to these.

The most important way in which the GRI can help companies radically improve their reporting is by focusing considerably greater energy on developing the eleven *Reporting Principles* that make up a significant part of the guidelines. These principles have the potential to drive companies' accountability efforts in important new ways, but have not been the subject of much further study or discussion since they were developed. We believe that a deeper understanding of these principles and their application is one major distinction between the top scorers and other reporters, but much work remains to be done to translate this best practice into improved common practice.

Where Next?

As the relatively short history of the GRI has already demonstrated, what is considered 'leadership' practice now will eventually become standard practice in the future; so even as the base of reporting companies continues to expand, they will continue to be influenced by today's best practice reporters. It is in the nature of good companies to innovate — and the reporting area should be seen as no exception. The Top 50 include many examples of this innovation.

Where the GRI once filled a niche as a platform for some of that innovation, it has, in working towards its mission, given way to a focus on raising common standards expected of ordinary businesses. Will it be the place to go for best practice in the future? There is no reason why it cannot — and a new focus around the reporting principles could provide real opportunity space. However, we suspect that the overriding focus on standardisation will continue to be GRI's highest priority for some time to come.

But the need for innovation remains, so we expect companies and stakeholders will eventually find a way to pick up where GRI leaves off in galvanising leadership companies and redefining best practice. And in that event, we should welcome ongoing experimentation and pioneering, even as we continue to support and encourage GRI on its present path. Efforts at both ends will always be necessary.

An invisible GRI is worked into the background fabric of what companies are required to do; a visible GRI is a challenging and inspiring framework for creating innovation and improved accountability.

Global Reporters 2010

7

Where will reporting be 20 years after the first voluntary reports appeared? We feature three impressionistic images of where the transparency revolution might take us: we wondered what it would be like if citizens and consumers could use a device that presented them with 360° information on products and services. Once akin to science fiction, such tools are likely to be everyday reality within a decade or so.

With over 1,500 companies reporting, many of them huge businesses with vast supply chains, the reporting agenda rests on much more robust foundations than in 2000, let alone 1990 — when the first voluntary corporate environmental reports appeared.

As a result, *Risk & Opportunity* concludes that the field is reaching critical mass. That said, the future may be characterised by the continuing fragmentation of interests and efforts (what we might dub the 'fission' scenario) or, more optimistically, by 'fusion' — with the integration of non-financial and financial reporting helping to drive a range of social and environmental priorities deep into the heart of 21st century capitalism and markets.

Our vision of the accounting and reporting future assumes a transition from Stage 2 fission to Stage 3 fusion (page 06). The obvious question is: Are we on the cusp of something really new, with the reporting field set to undergo radical changes, or are we entering a decade of consolidation and standardisation? Our crystal ball is suffering from a bit of static, but we suspect that we will see both — a mix of transformation and standardisation.

Half Full or Half Empty?

An optimist would hope that if we were to run this survey again in 2010 we would find that the average report score would be approaching, or even in excess of, today's top score (71%). If so, it would be a credit to the companies in the survey who have continually pushed, innovated and striven to be the best in reporting, and a credit to the voluntary reporting movement.

A pessimist might argue that the corporate responsibility movement of recent years will prove to have many of the same weaknesses of the much-vaunted New Economy, imploding under its own weight.

One result of this darker scenario would be the extinction of a growing number of reporting lines at companies, coupled with re-energised and — in this case — Machiavellian activity in such fields as corporate public relations and advertising.

A realist would probably look at the demographic, economic, political and technology trends and conclude that, while we will see ups and downs, the pressures on companies to become more transparent, more accountable and more responsible, and — ultimately — to help supply chains and economies to become more sustainable can only grow.

But, while the realist might accept that the ultimate outcome would probably be closer to the optimistic scenario, he or she would certainly dispute the significance of our Top 50 or Top 100 in 2010 achieving average scores in excess of 70%. Although this scenario may very well be possible, it would still leave behind the vast majority of companies, most of them much smaller than the ones covered in this survey. Most, intentionally or not, will continue to operate largely in 'stealth' mode. And who can blame them, given that without major changes to today's market signals, tomorrow's incentives will be too weak to drive the scale of change likely to be needed.[57]

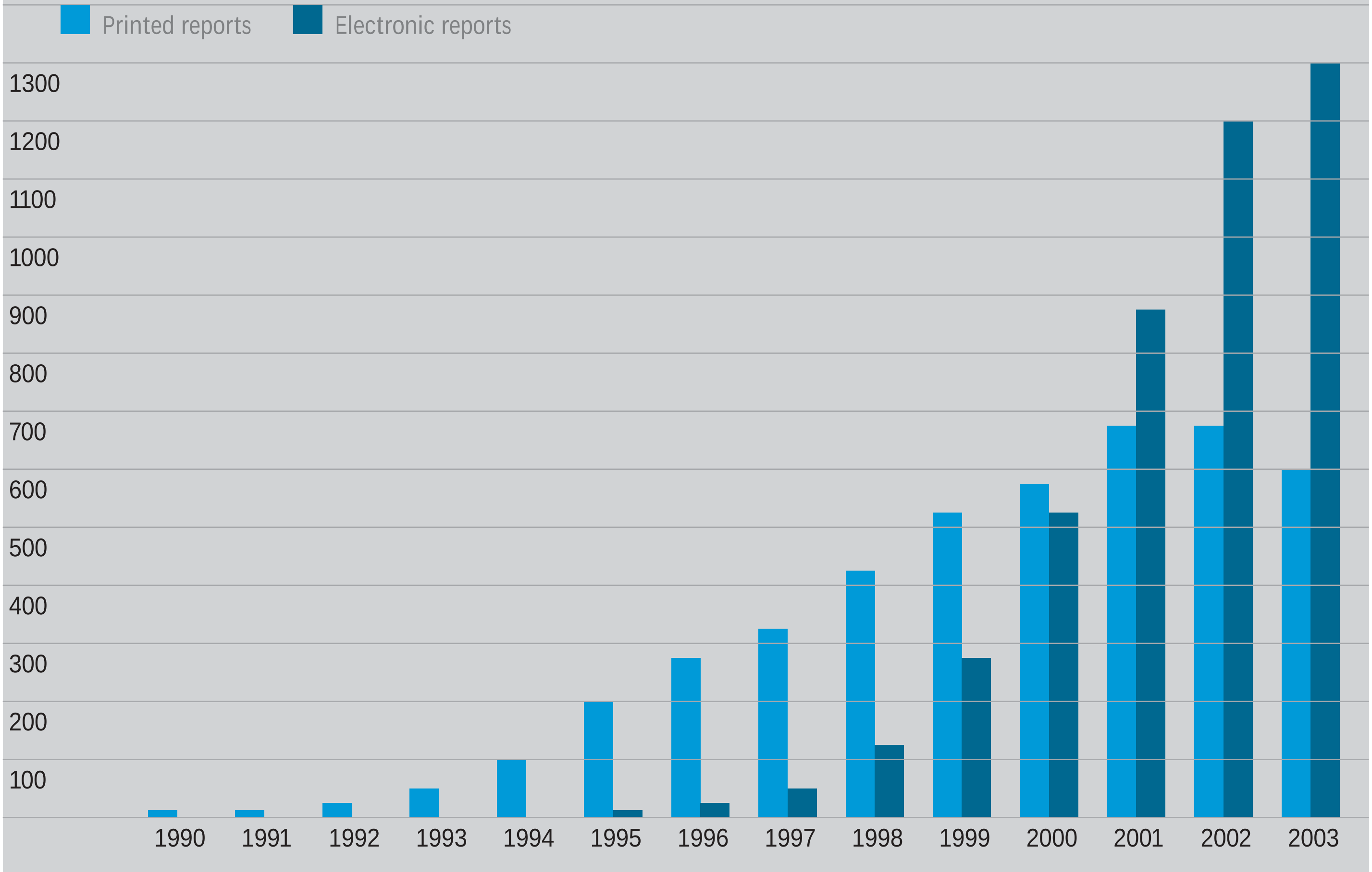
At the end of our sixth benchmark survey we find ourselves somewhere between the optimistic and realistic stances on the future of reporting. On the one hand, research by CorporateRegister underscores the extraordinary growth in corporate non-financial reporting since 1990. But history shows that very little in human affairs keeps going in a straight upward line forever. Indeed, the figures for hard copy, or printed reports, had clearly hit some sort of plateau by 2003, at least for the moment.

A pessimist might argue that the corporate responsibility movement of recent years will prove to have many of the same weaknesses of the much-vaunted New Economy, imploding under its own weight.

[57] See SustainAbility's report for the UN Global Compact, *Gearing Up: From Corporate Responsibility to Good Governance and Scalable Solutions*, 2004.


Envirocom
Coffee 100% certified FairTrade / 33.3% of purchase price will go to help FairTrade Farming Programs in Guatemala /
iReport
Coffee-Mart
Cappuccino
Sociocom
Dating Alert / 2 Coffee-Mart Customers match your Dating Profile / Contact Messages have been sent /
884.85
043.35
Update Report
Save Report
Send Report

30 Corporate Non-Financial Reports 1990—2003



Source: CorporateRegister.com October 2004 (based on a sample of 4478 printed and 4472 electronic reports)

This trend could reflect a number of other trends:

— Fatigue
After a fast-and-furious 14-year run, maybe the reporting trend has reached some form of stasis, either caused by the growing complexity of the agenda, or stalled by an understandable dis-inclination among smaller or lower profile companies to invest the necessary resources.

— Virtuality
Again, perhaps the growing use of electronic formats (also indicated by the CorporateRegister data) is taking over from hard copy reporting. If so, this trend could be powered by the much greater flexibility of electronic communication.

— Mainstreaming
Or, thirdly, maybe the results are a leading indicator of the emergence of Stage 3, integrated accounting, disclosure, reporting and communication.

All three trends are almost certainly at work, nor are they mutually exclusive. Indeed, Stage 3 accounting and reporting will increasingly address the issue of the growing complexity of non-financial reporting (perhaps now best symbolised by the use of indexing in the Top 50 reports) by using the extraordinary power of the internet, intranets and new knowledge management technologies, including advanced data-mining.

In terms of where we see this agenda headed over the rest of the first decade of the 21st century, here are some pointers:

— Shareholder activism
Groups like CERES, which helped kick-start both the early round of corporate environmental reporting and the GRI, are increasingly focusing on financial actors (such as pension fund trustees) as potential allies in the drive to force corporate change. This trend is likely to accelerate and could well help drive much greater financial market interest in issues as various as climate change and access to modern technologies like medicines.

— Assurance
As we argue on pages 32—35, this is an area in need of fairly radical innovation. The cost of current forms of assurance will be one of the factors discouraging wider reporting, a trend worsened when research suggests that the cost:benefit ratio for some forms of traditional assurance is questionable.


Update Report
Save Report
Send Report
Nutricom
Object Alert / Source not certified Organic / 24% Risk of exposure to harmful pesticides / 13% Risk of exposure to GM additives /
051.25
041.80
741.25
125g Apple
iReport
Nutricom
Object contains 14% of your RDA / Your Parental Nutrition Monitor has been updated /

31 Four Trajectories

Trajectory	Risks	Opportunities
Standardisation Shift towards common format accounts	— Indicators proliferate — 'Tick box' approaches and mind sets prevail — Emerging issues ignored — GRI-style innovation overtaken by big, more conservative partner like ISO	— Benchmarkability of reports is greatly expanded — Learning increases on performance, outcomes and implications for company valuation
Consolidation The shake-out begins	— Many niche players in the reporting area are marginalised — Some of the pressure on business evaporates — Loss of 'storylines' in reporting, together with some emotional appeal	— As language is consolidated reports become accessible to more readers — Sustainable development is built-in rather than an add-on — Language becomes less complex, more mainstream
Regulation Governments mandate reporting	— Narrower reporting — Reporting energy falls — Focus is increasingly on compliance, rather than experimentation	— Higher levels of disclosure overall — Silent sectors and companies begin to report — Corporate governance structures are forced to embrace a growing range of non-financial issues
Integration Non-financial and financial concepts merge	— Even narrower audiences for reports — Softer issues lost due to lack of evidence or inadequate understanding or metrics — More Frankenstein's Monsters (Figure 32)	— Information more persuasive for all audiences, not just financial actors — Business case easier to articulate — Non-financial priorities deeply embedded in company strategy

— Regulations
The early response to some of the new legislation in this area, for example France's NRE law, has been disappointing (page 07). Equally, the response to the UK Operating & Financial Review or OFR requirement (page 07) may be less dramatic than some proponents hope. But some such initiatives will open up new frontiers of experimentation, with leading companies using them as part of their business case to invest in the leading edge of transparency. And, where such experiments demonstrably work, forward-thinking governments — at least in the developed world — will swing into action to ensure that best practice spreads.

— Technology
New developments in information technology will make the job of accessing all of this information much easier — and, in many cases, much more challenging for companies.

Take XBRL,[58] or eXtensible Business Reporting Language, which is an evolving global standard for electronically tagging data in such a way that it can be automatically processed for collection and reporting. Computers can treat XBRL data intelligently, recognising it in documents, analysing it and then presenting it in a variety of ways automatically, depending on the user's requirements. As the need for more disclosure on sustainability data increases, such tools will greatly reduce the internal resources necessary for generating and using reports.

Finally, to set some of the likely outcomes of these trends in context, Figure 31 spotlights some of the risks and opportunities likely as the processes of report standardisation, market consolidation, regulation and the integration of at least some forms of non-financial and financial accounting and reporting proceed.

On this basis, while our crystal ball cannot tell us what reporting will look like in 2010, we are reasonably confident that there will still be a great deal of activity to discuss and benchmark.

The UN Global Compact's decision to encourage signatory companies to report along GRI lines is welcome — and will help drive the reporting agenda into new world regions and countries. Longer term, it should be made a mandatory requirement for members of all such consortia and networks. But the biggest step forward of all in this area will come when the International Chamber of Commerce (ICC), representing a much larger number of companies around the world, moves in the same direction. Stranger things have happened.

[58] XBRL International is a not-for-profit consortium of approximately 250 companies and agencies worldwide working together to build the XBRL language and promote and support its adoption. www.xbrl.org


Econocom
Shareholder Alert / 5.6% of your Pension Fund is invested in Pharmaco / CFO faces pressure to resign over recent liability lawsuits /
iReport
Pharm-Mart
Paracetamol
Medicom
Prescription User to consume next Dose / Take 2 x 500mg Capsules within next 30 minutes / Your Pharmacist has been alerted /
001.25
051.25
021.25
031.25
016.95
024.25
003.35
Update Report
Save Report
Send Report

32 Beyond Frankenstein's Monsters

Stage 3 reporting is struggling to be born. In response to the increasing burden of reporting, a number of companies have begun to integrate their annual and sustainability reports into one integrated volume. However, unlike an organ transplant where the donor organ and the recipient are physiologically matched, most of today's integrated annual and sustainability reports are uncomfortable combinations. Indeed, one of our analysts exclaimed that analysing such reports was a bit like dealing with Frankenstein's Monster.

Like Dr Frankenstein's handiwork, stitched together from ill-matched parts and sparked into life by a bolt of electricity, the first generation of integrated reports are not always pretty to look at. But the field is likely to be jolted into action — and life — as pressures for corporate accountability grow alongside accelerating concern around issues like climate change, an expanding range of human rights, diverse health issues (from HIV/AIDS and SARS through to obesity-related diseases) and corruption.

In Stage 2, there are clearly sacrifices to be made in moving towards an integrated report. Space in an annual report is prime real estate, so the amount of space available for sustainable development-related information is going to be limited. While an integrated report will present the information to a new set of stakeholders, particularly investors and shareholders, some Stage 2 audiences for standalone triple bottom line reports risk being left behind. For integrated Stage 3 reporting to work, three things will be critical:

— Language
Plain speaking is going to be key in presenting sustainability information in the integrated format, with an emphasis on mainstream language as the connector between the two worlds. Say goodbye to 'issues' and 'challenges', say hello to 'risks' and 'opportunities'. But, inevitably, new jargon will also emerge as the processes of integration work through. One term that is winning wider currency, for example, is *blended value*.[59] Like *sustainability* and *materiality*, blended value is something of a Holy Grail, but likely to be central to the Stage 3 era.

— Prioritisation
Sustainable development brings up a raft of issues for most companies, so many get lost in the blizzard. Since space and stakeholder mindshare are limited, indexing will be overtaken as a central challenge by strategic priority setting. This is where the overlap with corporate governance will be at its most energetic, with boards increasingly drawn into the fray.

— Context
Stage 3 reporting will see an expanded single bottom line, but developed and 'read' in a wider context. Progress — or the lack of it — will need to be set in the context of wider societal goals, including government and sectoral targets, and the extent to which initiatives have the potential to 'go to scale'.

33 The Soup Starts to Bubble

Early on in our work on corporate reporting, we predicted that once a global soup of data on non-financial performance had formed, new species would evolve to feed on it. The socially responsible investment (SRI) funds represent one life-form that has benefited from the growing availability of data, but in the process companies have begun to protest that they are inundated by questionnaires and other requests for data.

One solution proposed to tackle that problem comes from the London Stock Exchange (LSE), which hopes to centralise data-gathering for UK-listed companies. Useful, probably, but such institutions are often naturally conservative, which might blunt the pace of progress. So what might drive the pace of continuing evolution? Some clues are beginning as the 'soup' starts to seethe with new initiatives.

For years, we have been besieged by software developers claiming to have found the Holy Grail, the one-stop shop reporting software package. Our response has been increasingly sceptical, but now there are signs that real progress is on the horizon.

First, there is the new XBRL language option, described on page 47. This open source language will be used by growing numbers of companies and consultants to draw together digital data on financial and non-financial performance into integrated packages. GRI, too, is planning to be totally digital by the 2006 guidelines revision. Meanwhile, an approach gaining traction is that advanced by OneReport,[60] which promises to: cut the cost of reporting; streamline reporting processes; and 'deliver more timely and accurate information the research and rating organizations deem important' to assessing your company.

During the course of the 2004 benchmark round, we worked with California-based Natural Logic[61] to test our ICT sector results for evidence of real-world performance improvements. Focusing in on British Telecom, Deutsche Telekom, HP, IBM, Matsushita Electric, Philips, Ricoh and Sony, the team found it possible to develop comparative time series data in such areas as greenhouse gas emissions and non-hazardous waste flows.

The next question: How accurate and relevant are the results? This will need further testing. But the process underscored how critically important it is for all reporting companies to provide normalised, sector-relevant information. Inadequate data won't stop analysts analysing, ranking and rating your company, but you may not like the results of their work.

59 www.blendedvalue.org
60 www.one-report.com
61 www.natlogic.com

Conclusions & Recommendations

8

A growing field of companies are making real progress in sustainability reporting, which is reaching critical mass. Now comes the hard part.

We stand on the threshold of a new era in corporate disclosure, reporting and communication. Stage 2 experimentation in multidimensional reporting has taken root, is spreading around the globe and — on the basis of what companies tell us — is helping drive real performance improvements. The Top 50 reports give us reason to be hopeful.

Provided the Global Reporting Initiative (pages 38—42) can resolve its challenges, we are optimistic that it will continue to drive the spread of reporting — as will the new integrity initiatives adopted by the UN Global Compact for signatory companies, which include a strong encouragement to report according to the GRI guidelines.[62]

But even if a company were to gain a perfect score against our methodology (pages 17—19), this would still be no guarantee of the sustainability either of its immediate operations or of its wider supply chain. Perfect scorers could also be blind to the second element of our title, *Opportunity*.

Although the current challenges cluster around issues of risk, governance and materiality, the longer term challenge will be to position companies, their business models and their upstream and downstream activities to exploit market opportunities created by sustainable development in a timely, efficient and effective manner.

Enter Spitzer

Voluntary reporting, by promoting competition, has driven progress, but voluntarism will never be enough on its own. And in some quarters, patience is already wearing thin: witness the often breathtaking audacity of New York Attorney-General Eliot Spitzer, one of the leading proponents of the law as an agent of social change.

His latest environmental endeavour has him involved in the move by eight US states, including New York, to sue five US power companies — responsible for 10% of US carbon dioxide emissions — to force them to take action.

Spitzer himself may be a hero or a loose cannon but, regardless, he stands ready to push companies where they are unwilling or unable to go on their own. We need more champions like him and companies ignore the Spitzer factor at their peril. Given the growing relevance of sustainability reporting to the fundamentals of governance and business value, the stakes for reporters can only become higher.

Ten Challenges

In 2002's *Trust Us* we concluded that there were two new priorities at that time: *integration* and *materiality*. As this report noted above, we do sense the potential for real progress on both of these fronts. To help the reporting community think through what needs to be done before 2010, here are ten challenges we see as vital to shaping the reporting agenda:

1
Keep up the momentum
While the Top 50 and Other 50 include plenty of exciting new reports — from a wide range of sectors and world regions — there is no guarantee that the trend will continue, or strengthen much further. Market conditions must continue to demand and reward reporting — and begin to do so where this motivation is currently absent. This will require effort on the multiple fronts of *disclosure*, *reporting* and *communication*.

Perfect scorers could also be blind to the second element of our title, *Opportunity*.

2
Clarify and consolidate the language
We must watch our words. Philips, for example, says its report deals with the 'full spectrum of triple bottom line activities' which, it argues, are 'also known as sustainable development, corporate social responsibility (CSR), corporate citizenship, corporate responsibility, corporate accountability or 'people, planet, profit''. While individual companies may be more comfortable with some terms than with others for reasons of their own history and culture, the assumption that they are one and the same potentially breeds confusion and suspicion. Broad agreement on the language and concepts is of paramount importance.

3
Communication begins where reporting ends
One clear impact of the GRI guidelines has been to encourage more reporters to include more detailed indexes in their reports — Westpac, Barclays and HP are some of the leading indexers in this year's crop. This makes it easier for users looking for specific information to find what they need. But the next stage will require companies to take their reports back to their constituent messages, and find elegant and effective ways to bring these messages to key users. The one-stop-shop report serves a purpose, but a limited one, given that most users need more targeted *communication*.

4
Internet reporting must become more functional
It is clear that the rapid rise of internet-based reporting hasn't wiped out printed reports — nor is it likely to anytime soon. However, most reporters' internet-based reports offer little in the way of functionality over their hard-copy brethren. But there is great potential to make information more accessible and usable to 'data-miners' using tools like XBRL (page 47).

5
Keep up the effort on the economic bottom line
A number of reporters address the economic bottom line, but this is still frontier country. Diageo discusses economic impacts at some length and companies like Novo Nordisk now devote substantial space to the economic agenda. That said, the relevant concepts, indicators and expectations need considerably greater clarity and practical application for companies to respond to them effectively.

6
Explore the business case — but recognise that it is a limited tool
A growing number of reporters dedicate significant space to the business case for action. We welcome this trend, and see it as essential to capturing the attention of management and analysts alike. However, the business case in a simplistic sense will never capture the full complexity of business value. Continued research is needed on this front, in parallel with efforts to develop more sophisticated notions of value, wealth and sustainability.

7
The growing focus on governance and value drivers will lead to more advanced business models
Various companies in the Top 50 discuss their business models, including HP and Novo Nordisk. Greater detail and sophistication around business impacts will eventually lead to the need to explore at a more fundamental level how a company's basic design generates value. Understanding business models is key to assessing sustainability.

8
Talk to the financial markets in language they understand
It's a rare report these days, at least among our Top 50, that doesn't devote a fair amount of space to the socially responsible investment sector's view of the relevant company.

But wider risk management issues, including threats to business continuity, are creeping in (see Natura). This is hugely important to engaging the financial sector — and the corporate mainstream — around issues of sustainability.

9
Corporate governance is the big issue — and there's nothing simple about it
Recent events have driven key corporate competencies, culture and decision-making to the top of the agenda for many observers. But current approaches to understanding and reporting on governance are simplistic and risk missing the point. Clarifying what behaviours and skills boards and executives need to lead successful, accountable companies represents a tremendous opportunity space.

10
The framework of standards, codes and norms must be tightened
While initiatives such as the GRI, AA1000, the Global Compact and Kimberly Process may individually enjoy a degree of success, their impact will be vastly expanded by closer alignment. In addition, the different roles for voluntary schemes, mandatory requirements of all sorts, and professional services such as assurance need clarity and a greatly improved body of evidence to go beyond niche practices.

In terms of the bigger picture, we conclude that the transition to Stage 3 disclosure, reporting and communication will be well under way by 2010. Indeed, a few leadership companies are already talking in terms of significant innovations in this area in their 2005 reports.

The crux of the matter will be that these companies will increasingly try to integrate their financial and non-financial thinking and decision-making, in order better to understand and manage the dynamics of both.

[62] SustainAbility & UN Global Compact, *Gearing Up*, 2004.

Recommendations

We offer the following recommendations for several groups of people who will play central roles in building the Stage 3 agenda — and in making it an everyday business reality.

CEOs and Corporate Boards

1 Test
Assess whether your company or organisation's professionals and business units are responding to the most material priorities — and whether they understand and can respond to the emerging risk assessment, reporting and assurance agendas.

2 Embed
Ensure that emerging priorities are adequately addressed in balanced scorecards and other incentive schemes.

CFOs and Investor Relations

3 Rethink
Work out how to blend your company or organisation's non-financial accounting, reporting and assurance activities with its mainstream financial counterparts.

4 Review
Learn from the latest rating tools — such as the risk assessment frameworks used by financial analysts — to evaluate your disclosure, reporting and communication activities.

5 GRI
Help build the infrastructure by getting actively involved in the development of the Global Reporting Initiative (pages 38—42), ensuring that it maintains momentum and that its work meets the needs of financial stakeholders and other users.

Corporate Responsibility and Sustainability Professionals

6 Boards
Encourage your CEO, board and chief financial officer (CFO) to review the company or organisation's disclosure, reporting and communication strategy in the context of the trends and expectations reviewed in *Risk & Opportunity*.

7 Risk
Help your internal risk management people to identify and prioritise the main non-financial risks. Try applying the Materiality Multiplier (page 35) to your reporting.

8 Opportunities
Engage your business development people to understand the relevant opportunity — and growth-related thinking in your reporting and communication — and in other key areas of the business.

Investors and Other Stakeholders

9 Respond
Read at least a sample of Top 50 reports in sectors of interest. Compliment and challenge reporting companies. Given the relatively low rates of response to reporting companies, even small numbers of informed comments can have major impacts.

10 Encourage
Pressure companies to report on non-financial risks and opportunities with (at least) the same rigour as they conduct their traditional financial reporting. Compliment them when they do — and encourage non-reporters to begin the process.

And, finally, if there were to be an 'Eleventh Commandment', it would probably be: Remember that reporting is a necessary condition for engagement and action, not a substitute.

SustainAbility Clients 2002—2004

Top 50 / Other 50 Companies	Engaging Stakeholders Members	SustainAbility Clients
ABB	Member	
Abbott Laboratories	Member	Client
ABN Amro Real		Client
Alcan		Client
Allianz Group		
Anglo American	Member	Client
Aracruz Celulose		Client
Aventis		Client
BASF	Member	Client
Baxter	Member	
BHP Billiton	Member	
BP	Member	
Bristol-Myers Squibb	Member	
BT Group		Client
Canon		Client
Chiquita Brands International	Member	Client
City West Water		
DaimlerChrysler		Client
Deutsche Telekom	Member	
Ford		Client
Gaz de France		Client
General Motors	Member	
HP	Member	Client
ING Group		Client
Intel Corporation	Member	
Mirant	Member	
Novartis	Member	Client
Novo Nordisk	Member	Client
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In the interests of full disclosure, we have indicated which of the reports in the Top 50 and Other 50 are from SustainAbility's Engaging Stakeholders program members or are clients.

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