BEYOND THE GAAP

Triple-bottom-line reporting changes how businesses and shareholders view corporate imperatives

By Anne Papmehl

While the mention of triple-bottom-line reporting may elicit Enron jokes, those familiar with the term regard it as an inevitable step in the journey towards greater corporate transparency. A triple-bottom-line report discloses three interrelated organizational imperatives — economic prosperity, environmental integrity and social contribution.

Triple-bottom-line (TBL) reporting is the latest evolution in what is often referred to as corporate sustainable development or corporate social responsibility (CSR) reporting, with a couple of subtle yet significant distinctions. Whereas CSR reports are very much forward-looking, qualitative pieces, TBL reports are quantitative summaries of a company's economic, environmental and social performance over the previous year. The TBL reporting trend reflects a global shift towards standardization of what and how information should be disclosed to the public, to create a meaningful platform for comparisons of criteria other than financial performance.

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A number of factors are driving this transition. First, a company's license to operate is no longer granted by any one level of government or single regulator, but by public stakeholders who have unprecedented access to a company's financial and non-financial areas of management. "This is one of the often unheralded aspects of globalization," explains David McGuinty, president of the National Round Table on the Environment and the Economy (NRTEE) in Ottawa, an independent federal government agency. "Information is available to anyone who can download it, including environmental and social activists, and companies are realizing they can run but they can't hide. That driver is now compelling many companies to disclose more transparently."

Second, there is growing recognition within the institutional investment community that socially responsible investment funds (SRI) are no longer fringe entities. Publicly traded companies are eager to qualify the portfolio screening criteria for many of these funds, and a TBL report, with its quantitative focus, is an ideal vehicle for communicating this information to institutional investors.

Third, many shareholders and consumers who want to avoid companies with poor environmental and social track records are demanding more comprehensive information to factor into their decision making.

And lastly, the use of TBL reports is also motivated by the desire to enhance share price performance. All these drivers bear some weight on a corporation's competitive edge.

Environmental indicators

The transition to TBL reporting comes with some formidable challenges. Chief among them is determining what should be disclosed on the environmental and social bottom lines. While generally accepted accounting principles (GAAP) guide financial reporting, no standardized metrics exist for measuring an organization's environmental and social costs and benefits. In addition, TBL is voluntary and many of the current reporting metrics, known as indicators, are fragmentary at best.

However, standards-setting organizations like the Global Reporting Initiative (GRI) and Accountability have been active in moving TBL reporting standards along a more defined path by working closely with public accounting firms, public interest groups and the companies themselves to extend GAAP principles to the environmental and social bottom lines.

One complication in adopting the TBL reporting format resides in the variability of environmental and social reporting indicators across industries and geographic regions. "An oil and gas company operating in western Canada will have very different environmental and social issues than a manufacturer of sneakers in a third world country," explains Mel Wilson, senior manager and environment management specialist at PricewaterhouseCoopers in Calgary.

"In concrete terms," says Wilson, "this means that the Canadian oil and gas company, on the environmental front, will be looking at CO_2 emissions and the impact to the land, while the main social issue would likely be dealing with aboriginal communities. Labour standards issues are rare with petroleum companies operating in Canada, but they tend to be front and centre with producers of retail commodities at a third world manufacturing site. So, to make the disclosure meaningful, you have to link the indicators to your specific operations and to your stakeholders."

But in a world where indicators and standards proliferate, choosing the indicators most appropriate to your individual business can prove difficult. For this reason, some companies like Dupont develop their own. "We feel the indicators must be connected strategically to what we are trying to accomplish in our business," explains Colleen Brydon, manager, social innovation enterprise with DuPont Canada Inc. in Mississauga, Ont. "Rather than use some kind of generic objective standards that determine what and how we report, we look at how the three pieces of environment, economy and society are interdependent in order to achieve that strategy."

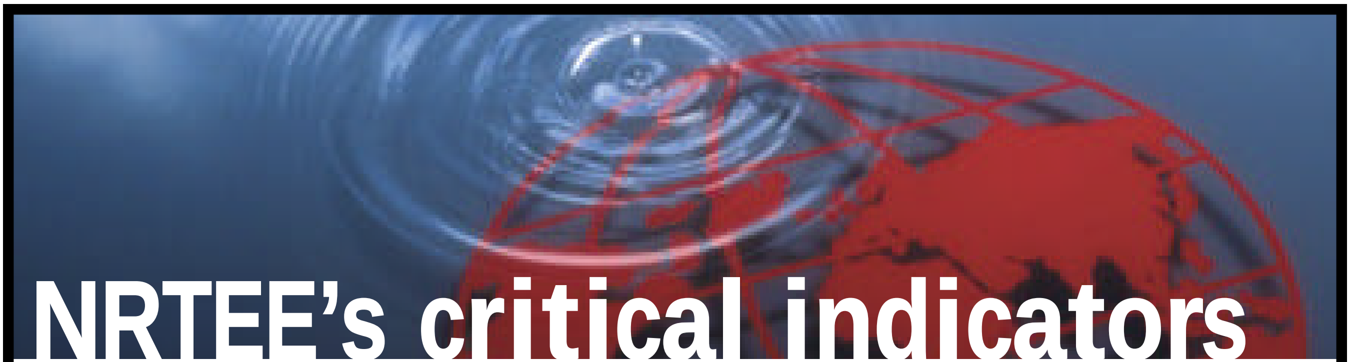
Other companies, such as BC Hydro, use a combination of GRI guidelines and their own independent work within the organization to identify indicators that fit both their business and stakeholder objectives.

David McGuinty admits the proliferation of indicators sometimes contributes to more confusion than they purport to eliminate. "There are a dozen approaches to this movement and what's being reported doesn't always lend itself to meaningful comparison. We looked at a number of these standards a few years ago and found them to be problematic not only in trying to compare companies between sectors but also companies in the same sector."

Seeing an opportunity for improvement, McGuinty's organization joined forces with 12 Canadian companies for a pilot project to identify and define indicators of environmental and economic efficiency (eco-efficiency). The project resulted in three fairly solid, robust, measurable eco-efficiency indicators - energy, waste and water intensity criteria, which McGuinty feels "have gone some distance in helping nail down the metrics and allow for comparison within and between sectors on both the environmental and economic fronts."

Social indicators

Indicators on the social bottom



NRTEE's critical indicators

The National Round Table on the Environment and the Economy (NRTEE) in Ottawa has established three core indicators to measure and track material use, which are key for the environmental integrity component of a TBL: energy intensity, waste intensity and water intensity.

The basic or core energy intensity indicator measures the indirect and direct use of fuels to produce or deliver a product or service. It is measured in megajoules and is meant to include measurements of electricity, gas, oil, coal, coke and other sources used in production and delivery.

The core waste intensity indicator measures all of the material used in the process of producing a product minus the material that ends up in the product. Waste is considered anything from the production process that is disposed of, released into the environment or considered a useless by-product of the manufacturing process.

The water intensity indicator measures the amount of water used in the production of a product or the delivery of a service. It includes all water taken from wells, municipal supplies or bodies of water.

NRTEE has detailed descriptions of how to make these measurements, and advice for companies that wish to calculate a number of other complementary indicators in its Eco-efficiency Workbook. The complementary indicators help companies determine a more specific breakdown of the use of these indicators.

The workbook also offers readers insight into possible exceptions they might encounter while making these calculations. For instance, what if a company generates its own electricity? what if a company has its own waste landfill, or what if a company uses rain water as a source of cooling in the production process? For more information check out the Web site at www.nrtee-trnee.ca/Publications/Eco-efficiency_Workbook/index.html.

line are harder to measure. "It's very difficult to say, 'We'll make this much money if we do this one nice thing,'" says Allison Morrison, project manager of the social bottom line initiative at BC Hydro. Whereas environmental or eco-efficiency indicators have some measurable effect on the costs or savings of the financial bottom line, social systems don't. "It doesn't matter how hard you try to be quantitative, you always encounter a subjective element with social performance indicators."

Social indicators can also be costly to the company. "When you're reporting on social performance to your stakeholders, there are costs associated with any initial consultation to determine suitable indicators," says Morrison. "Then you have to take the steps to measure your performance against those indicators and report back to your stakeholders, so it can get very expensive in person hours alone. Furthermore, you want to make sure you're choosing indicators that are meaningful and drill back value to the company."

A further challenge with social issues is their tendency to change and evolve over time. "One thing we have found is that people are not interested in survey results, but they are very interested in whether our safety numbers have increased or decreased over the years," says Morrison. "Last year we reported on fewer social indicators but tried to make them more meaningful to the audiences we reported to. For us at BC Hydro, the risks associated with the social bottom line overall have less to do with popular approval or media hits. We are trying to unearth the paths to value for the company to understand how our performance on the social bottom line equates back to profitability."

That may be fairly straightforward when dealing with employee health and safety, where the costs or savings to the bottom line are obvious, but how does a company ascribe value to the more nebulous social issues, such as "contribution to society"?

"I think this is where the social model superimposed on the corporate model leaves a definite gap," says McGuinty. "It's very hard to define social responsibility. I can tell you what it means in terms of dealing with aboriginal communities, but I think it's unrealistic to expect CSR to mean that companies are now responsible for full employment or a just society." McGuinty believes that a lot of the practical social concerns such as health and safety and aboriginal communities can be measured through the metrics of the environmental bottom line. "I think you can get to a lot of social benefits and economic benefits through the back door of environmental quality," he says. And perhaps this is the direction that reporting will eventually have to take.

For the time being, however, more and more companies are moving forward in reporting on three bottom lines through CSR or TBL reports, or some variation thereof. Currently, in Canada, about 150 such reports are being produced, with an estimated 1,500-2,000 worldwide.

Risk management and intangible benefits

The motivation for many companies to produce TBL or CSR reports is based on the belief that it enhances share price performance. Few, however, have really stopped to question and analyze this assumption. To date, no direct causal relationship has yet been established between the two, though many TBL or CSR practitioners see its value from a risk management perspective.

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"Risk is an intangible but significant issue that affects share price and is at the heart of investment strategies," explains Mel Wilson. "Almost all the information that a company can issue about its activities and operations, including the environmental and social aspects, can be fed into this bigger assessment of its ability to identify and manage risk. By communicating back to potential investors and your existing shareholders that you are monitoring and managing risks appropriately, you provide some assurance that you are a reasonably safe investment."

If, in the final analysis, the direct financial benefits to TBL are not apparent, there may be indirect benefits to financial performance and, hence, shareholder value through a linked chain of cause and effect: by reporting on its triple bottom line, the corporation shows it has nothing to hide; this in turn speaks well to its image as a good corporate citizen, which in turn bodes well for good stakeholder relations. A company with a reputation for being well-managed tends to have an easier time attracting investment capital, obtaining public approval for their license to operate and borrowing money. All of these properties, collectively, can have a positive effect on share price. And that appears to be reason enough for many companies to TBL report.

Turning that argument around, few would argue that an unfavourable image, wrought by irresponsible environmental and social practices, would negatively affect the company's ability to create shareholder value. "Companies behind non-environmentally-friendly or destructive initiatives are not going to be supported by anybody, including institutional lenders," says Wilson. "It's simply not good business management to lend to companies whose liabilities could materially affect their net worth."

As for whether TBL reporting will become mandatory, Wilson believes that there will eventually be some rudimentary requirement in Canada, but not in the immediate future. "It doesn't make sense to regulate it in the early growth stages. You let the market drive it because that is where the evolution takes place. Regulations are almost always, by their very nature, something you do to get the laggards up to standard — and right now, it's best to let the market play out so the leaders can emerge."

Nevertheless, TBL is likely to be around for some time as the business world accepts that environmental issues are not going away. "There is a recognized need now to live within the carrying capacity of the globe," adds McGuinty. "That internalized understanding is the first step in a larger portfolio of change management activities that are occurring in this area in a lot of companies and there is a race to be leading edge on this."

But, McGuinty cautions, "TBL has to be steeped in the reality of accounting, fiscal and free-market rules and regulations, and there's not a lot of time for blue sky gazing in today's corporate world. There are questions going on now in terms of how companies ought to move creatively and progressively down this path, but it is very much a rear-view mirror look back at how well we do and what kind of value we are generating now in these areas."■

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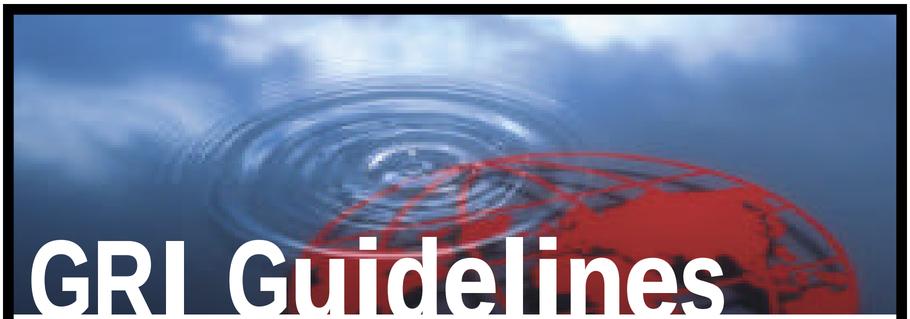

GRI Guidelines

The Global Reporting Initiative (GRI) will release a new version of its *Sustainability Reporting Guidelines* in July 2002, after two years of consultations with advocacy, labour and governmental organizations, and testing by a number of corporations.

The GRI was inaugurated as an independent, permanent institution at an event on April 4, 2002 at the United Nations headquarters in New York City, five years after its inception in 1997.

At the time of printing, a draft version of the *Guidelines* was available on the GRI Web site — www.globalreporting.org. At 85 pages, this document isn't exactly light reading, but it clearly outlines GRI's concept of what should be considered when judging economic, environmental and social performance. As it states, the Guidelines are meant to be a reporting framework to help organizations communicate their attempts to improve sustainability performance and the outcomes of those actions. It deals with both quantitative and qualitative measures.