A Climate of Convergence:

The U.S. Road to Global Reporting Standards

A research report prepared by CFO Research Services in collaboration with ACCA

CFO research services

ACCA

Part 2 — Global Sustainability Reporting

A not-for-profit foundation incorporated in the Netherlands, the Global Reporting Initiative (GRI) is the body at the forefront of global sustainability reporting, an activity that companies may or may not adopt. GRI is backed by the UN Foundation, U.S. Environmental Protection Agency, and many other government and private-sector supporters. In 2006, GRI released the third version of its sustainability reporting guidelines, which set out the principles and indicators that organizations can use to measure and report their economic, environmental, and social performance.[7]

The ISO 14000 family of standards was developed by the International Organization for Standardization for voluntary adoption by companies worldwide. This set of standards addresses environmental management by businesses and other organizations, with the aim of minimizing harmful effects on the environment caused by their activities, and achieving continual improvement of their environmental performance.[8] GRI refers its users to ISO 14000 standards in the section of its guidelines that addresses environmental efficiency issues.

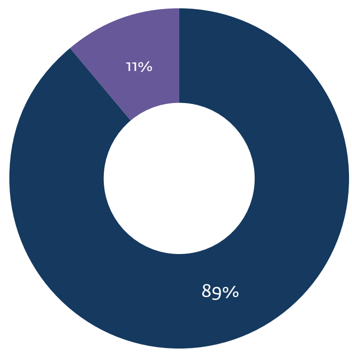
Awareness and adoption

Asked whether they believe a single set of standards for global sustainability reporting brings or will bring benefits to their company, a resounding majority of U.S. respondents (89 percent) say yes (*Exhibit 9*). It seems everyone approves of the idea—89 percent of respondents surveyed elsewhere agree that having one set of global standards for sustainability reporting will bring benefits to their company.

However, a significant proportion of U.S. respondents evidently do not know much about the issue. A huge majority say they either have not heard of GRI's sustainability reporting guidelines (36 percent) or have only sketchy knowledge of them (49 percent). Awareness of the ISO 14000 standards is equally low, with 43 percent saying they have not heard of them and another 40 percent admitting to having no real knowledge (*Exhibit 10*).

Asked whether they believe a single set of standards for global sustainability reporting brings or will bring benefits to their company, a resounding majority of U.S. respondents (89 percent) say yes.

> Exhibit 9: Are there benefits from global standards for sustainability reporting?



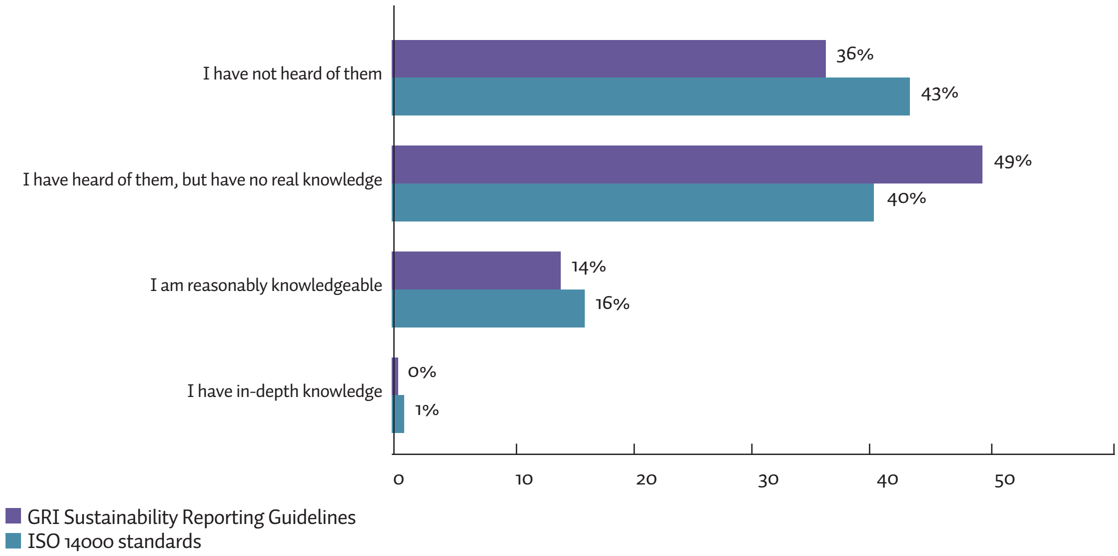
Base: 105 respondents

In this, the U.S. is no different from the rest of the world. Awareness of both GRI and ISO 14000 is also low in Asia and Europe, with 88 percent saying they have not heard or have no real knowledge of GRI guidelines and 75 percent saying the same of ISO 14000 standards.

Little wonder that only 21 percent of U.S. respondents have adopted or plan to adopt the voluntary GRI guidelines, while just 19 percent have adopted or plan to adopt ISO 14000 standards (*Exhibit 11*). The adoption rate is lower in the U.S. compared with the rest of the world—33 percent of respondents in Asia and Europe say they have implemented or plan to implement the GRI guidelines, while 46 percent say the same of ISO 14000 standards.

[7] Website of the Global Reporting Initiative at www.globalreporting.org
[8] Website of the International Organization for Standardization at www.iso.org

> Exhibit 10: U.S. knowledge of guidelines and standards for sustainability reporting



Base: 105 respondents

In addition, 27 percent of U.S. companies will not adopt the GRI guidelines, compared with just 16 percent who say the same in the rest of the world. The proportion of U.S. respondents who will not adopt ISO 14000 standards also stands at 27 percent, compared with only 13 percent among respondents in Asia and Europe.

Why is the U.S. behind the rest of the world on sustainability reporting? "It's a bit of the spirit of the times there, I would guess," speculates Ernst Ligteringen, GRI's chief executive. "Interest is growing, but not at the same pace as in Europe, or in some Asian and Latin American countries. Sometimes people need to be confronted with a serious issue. We have seen in various instances where there have been critical incidents, and suddenly social and environmental issues really come to the fore."[9]

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> Exhibit 11: What is the stage of adoption of these standards in your company?

	Full or partial adoption/planned adoption		No plan to adopt		Unable to comment	
	U.S.	Asia and Europe	U.S.	Asia and Europe	U.S.	Asia and Europe
GRI Sustainability Reporting Guidelines	21%	33%	27%	16%	52%	51%
ISO 14000 standards	19%	46%	27%	13%	54%	41%

Base: 105 U.S. respondents and 353 respondents in Asia and Europe

[9] Interview with Ernst Ligteringen, chief executive of Global Reporting Initiative, July 30, 2008.

Adoption will almost certainly quicken if it can be proved that there is a direct link between sustainability reporting and share-price performance. "That's the Holy Grail," says Ligteringen. He knows of several studies, but he doesn't think they are "absolutely conclusive."

The Bush administration has also been notably lukewarm towards environmental issues, despite (or perhaps because of) prodding by activists like former Vice President Al Gore. In contrast, France enacted the NRE (Nouvelles Régulations Économiques) Law in 2002 requiring all French corporations to report the sustainability of their social and environmental activities. In general, governments don't want to use the blunt instrument of regulation, says Ligteringen, "but they're looking at how they can steer attention towards [sustainability reporting] because they are aware that these will become material issues for the market."

The power of knowledge

The U.S. sample is too small to draw conclusions about whether reasonable or in-depth knowledge of GRI and ISO 14000 will lead to greater adoption. However, the findings of our global survey (which includes U.S. respondents) suggest that this may be the case.

Exhibit 12 compares adoption rates among the total respondents and the smaller segment comprising executives who say they have reasonable or in-depth knowledge of GRI and ISO 14000. Only 32 percent of total respondents say they have adopted or plan to adopt GRI guidelines, with 41 percent per Exhibit 12 saying the same of ISO 14000 standards.

Among executives who know GRI guidelines, however, the actual and planned adoption rate soars to 77 percent, while the actual and planned adoption rate among those who know ISO 14000 is even higher at 85 percent.

It may be that if GRI and its supporters succeed in raising awareness in the United States, they may be able to increase adoption in that country as well.

Sustainability and share price

Adoption will almost certainly quicken if it can be proved that there is a direct link between sustainability reporting and share-price performance. "That's the Holy Grail," says Ligteringen. He knows of several studies, but he doesn't think they are "absolutely conclusive." One study (not the one by CRD Analytics referenced below) found that the share price of companies that issue sustainability reports are more stable than those that do not. "Some others show a positive correlation, but that is questioned by others," Ligteringen says.

> Exhibit 12: What is the stage of adoption of these standards in your company?

	Full or partial adoption/planned adoption		No plan to adopt		Unable to comment	
	Total respondents	Those with reasonable/ in-depth knowledge	Total respondents	Those with reasonable/ in-depth knowledge	Total respondents	Those with reasonable/ in-depth knowledge
GRI Sustainability Reporting Guidelines	32%	77%	18%	10%	50%	13%
ISO 14000 standards	41%	85%	16%	6%	43%	9%

Base: 661 total respondents; 89 who know GRI; 151 who know ISO 14000

"The GSI 50 had an 11.55 percent alpha over the S&P 500 and 25.52 percent over the Nasdaq Global Index for the first-year return. Through the second quarter, the GSI 50 outperformed the S&P 500 by 16.89 percent and the Nasdaq Global Index by 27.14 percent."

A recently developed Global Sustainability Index (GSI) developed by U.S. consultancy CRD Analytics suggests that large public companies that are deemed to have sustainability practices in place tend to do better than their peer group as a whole in the stock market. CRD assessed companies in the Fortune Global 500 by turning more than 100 environmental and social key performance indicators in GRI's Sustainability Reporting Guidelines and other KPIs CRD developed into ratios relative to key financial matrices. The top 50 scorers became the constituents of the GSI 50.

CRD then calculated the return on the GSI 50, the S&P 500, and the Nasdaq Global Index over a one-year period and through the second quarter of 2008. "We definitely found a strong link between sustainability and stock performance," says Michael Muyot, CRD's president. "The GSI 50 had an 11.55 percent alpha over the S&P 500 and 25.52 percent over the Nasdaq Global Index for the first-year return. Through the second quarter, the GSI 50 outperformed the S&P 500 by 16.89 percent and the Nasdaq Global Index by 27.14 percent." [10]

Muyot says more work needs to be done. "We have to see what the next two years will reveal," he notes. It may be that the GSI 50's commodities, mining, and alternative energy constituents, which have been investor darlings as plays on the commodities boom, are what is driving the outperformance, even as the S&P's banking and financial constituents, which are bearing the brunt of investors' ire because of their subprime mortgages exposure, are bringing down the returns on the S&P 500.

To address this issue, Muyot says CRD will run more in-depth fundamental and technical analysis. "The weightings can also be adjusted, depending on the purpose of the reporting," he adds. "What we know is that we can go back further to look at overall stock performance, but not in conjunction with sustainability performance data, since most companies didn't report [in the past]. The one sector we can probably look at is energy, since [energy companies] have been forced to address the environmental impact of large oil spills, pollution and safety issues that came to the public awareness."

CRD plans to continue updating sustainability performance data annually and financial data quarterly as these become available. But Muyot is ready to draw some conclusions from the research already done. From the current 200, the number of companies that measure and quantify will increase to over 1,000 over the next couple of years, he predicts. "Stock performance will always be volatile, but 'sustainable' companies will experience below average volatility and above average ROE," he says.

Muyot also expects the SEC to mandate disclosure of carbon footprints and other environmental risk factors in company 10k filings and annual reports. "The impact of a federal cap and trade [carbon dioxide emissions program] in the U.S. along with comparable regulations in Europe, Asia and South America will push the carbon credit trading industry into the multi-trillion stratosphere," he concludes. "And the leaders in adopting clean and renewable energy options in the technology and energy sectors will really jump off the page."

[10] E-mail interview with Michael Muyot, president of CRD Analytics, August 12 and August 19, 2008.

Conclusion

It bodes well for the cause of global standards that the United States, which is still the world's largest economy, appears determined to see U.S. GAAP converge with IFRS. It can only be a good thing when investors and other stakeholders are able to make apple-to-apple comparisons of financial statements prepared by companies wherever they are in the world, including the United States.

But the U.S. road to convergence and eventual IFRS adoption is obviously long and challenging. Cutting down 25,000 pages of rules to 2,500 (or fewer) pages of principle-based standards is a daunting task. FASB and IASB appear to have established good rapport in the past six years, but reconciling their respective standards by 2011 and moving the U.S. to IFRS afterwards require much more than good intentions.

Both FASB and IASB should start winning hearts and minds now. One way of doing this is by involving as many preparers and users as possible in the consultative process. FASB has a robust feedback system on its website that dates back to 2002, involving putting up all comments made on exposure drafts and other proposals and making available audio files of meetings that discussed the comments. IASB has a newer system on its website (the comments date back to 2007). However, it is not enough just to have these mechanisms in place. Both bodies should also inform preparer and user groups about their existence, and actively solicit comments from them.

The SEC should be applauded for finally coming up with a proposed timeline. One striking finding of this study is the significant proportion of U.S. companies that have not been doing much to prepare for IFRS, having adopted a wait-and-see attitude. This may be due to expectations that the SEC will not make adoption of IFRS mandatory. Now that the SEC has made its intentions clear, we hope the fence-sitters will start preparing in earnest.

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On sustainability reporting, GRI and ISO, and their partners and stakeholders should redouble their efforts to inform and educate U.S. companies about their respective guidelines and standards. Our global study found a high rate of actual or planned adoption among executives who claim they have reasonable or in-depth knowledge of GRI's sustainability reporting guidelines and ISO 14000 standards. This suggests that the guidelines and standards have reached a level of maturity that makes them attractive to companies—if they only know about them.

It is clear from this research that CFOs and other business executives surveyed in the U.S. believe that both global financial standards and global sustainability reporting guidelines are, on balance, beneficial to their company. That goodwill could serve as a foundation on which IASB, GRI and ISO, and their partners and stakeholders, can build to persuade American companies to adopt their global standards going forward.

In particular, we wanted to find out the extent to which CFOs believe that global reporting standards are delivering the transparency and consistency they were designed to achieve. Or has that aim been lost over time, with standards being viewed as simply tools for regulatory compliance?

Global reporting standards and the CFO

This report forms part of an ambitious multinational survey on global reporting standards carried out by CFO Research Services on behalf of ACCA, the global body for professional accountants.

The project was commissioned by ACCA as part of a wide-ranging examination of the international business community's attitude toward, and acceptance of, global standards. In particular, ACCA wanted to establish to what extent business is seeing tangible benefits from the increasing globalization of standards. In addition to looking at the United States, CFO Research Services surveyed senior finance executives in Asia Pacific, Europe, and India.

In particular, we wanted to find out the extent to which CFOs believe that global reporting standards are delivering the transparency and consistency they were designed to achieve. Or has that aim been lost over time, with standards being viewed as simply tools for regulatory compliance? We have a responsibility to the business community we serve to take a step back and ask, "Are global standards delivering benefits to shareholders and users of company reports?"

On one hand, proponents will point to the growth of global capital markets and how this has been facilitated by adherence to the same sets of financial reporting and auditing standards. To operate efficiently, these markets need transparency and the confidence that this transparency engenders. The ability of companies to list on multiple exchanges has, without doubt, been simplified.

But others will argue that global standards are only about big business. And, perhaps more worryingly, they would say that global standards are driving an increasingly expensive compliance agenda without bringing benefits to business, its shareholders, and wider stakeholders. CFOs themselves have an interesting perspective on this, as this report shows.

To put the debate at its simplest: are global standards producing reports and information which are helping business to analyze and manage their performance, and which are helping investors and wider stakeholders to understand and quantify performance for their various needs? This is the fundamental question we were seeking to answer through this research.

U.S. results

It is encouraging to see that, on balance, CFOs in the U.S. can see the benefits to business of such standards. And especially reassuring that someone like Martyn Webster, the vice president of finance at XenoPort Inc.—who has extensive experience of both U.S. GAAP and IFRS—is firmly in favor of principles-based global financial reporting standards, recognizing that they are essential to being part of a global capital market.

Given that the SEC is only responsible for listed companies, it is interesting that 61% of respondents believe that IFRS will become mandatory across the board. With 83% believing that adoption will be at least voluntary, the move to IFRS is clearly seen as a live issue for everyone.

The U.S. portion of the research proved particularly timely. Just weeks after the survey was concluded, the SEC announced its proposed timetable for a switch to IFRS. Under its proposals, U.S. companies could have the option of reporting using IFRS as early as 2010. The SEC would then decide in 2011 whether to make IFRS mandatory for listed companies from 2014.

The survey shows that, even before the SEC announcement, many companies were already taking a variety of active steps to pave the way for IFRS implementation. From ACCA's experience, this is a very good state of preparedness when compared with European businesses at an equivalent stage in the process. For the 35 percent of CFOs adopting a "wait and see" stance, seeing the steps others are taking will hopefully be helpful as they plan their next move.

CFOs in Asia Pacific, Europe, and India saw a marked contrast between what they see as the main purpose of global financial standards at the moment (a reporting tool) and what their main purpose should be (an aid to investment decision making). In the United States, the CFOs were much more ambivalent about the purpose of the standards, with as many feeling they should be a reporting tool as those who believed their primary purpose should be to help investors. This seems to point for a need to re-examine what and who reporting is actually for in this connected global market.

The picture regarding the usage of CSR reporting standards is, on the face of it, encouraging. Eighty nine percent of U.S. CFOs surveyed believe that global sustainability reporting is, or would be, beneficial to their company. But beneath the headline there is less good news. Only 21 percent had adopted or plan to adopt the GRI guidelines, with just 19 percent adopting or planning to adopt ISO 14000. This is the lowest rate of acceptance in any of the regions surveyed. We would concur with the report that cultural background plays a part in this—there is still significant skepticism in the U.S. over the need for sustainability reporting, compared with other regions of the world. Professional bodies and others who believe in the value of CSR reporting clearly need to do more in this arena. Through the Ceres-ACCA North American Sustainability Reporting Awards, ACCA has been working to raise awareness of the benefits of CSR reporting since 2003. During this time, we have seen the number of entries grow to a record 87 in 2007 with Ford Motor Company, Timberland, Dell Inc., and Suncor Energy winning awards. But this survey shows there is clearly still more work to do in turning approval into action, and putting sustainability reporting higher up the CFO's agenda, along with other developments in non-financial reporting.

About ACCA

With 122,000 members and 325,000 students living and working in 170 countries, ACCA is a leading voice in the global accountancy profession. We attract students and develop members who seek internationally recognized finance skills and expertise and support employers in equipping them with a globally mobile workforce. Not surprisingly therefore, ACCA has been at the forefront of championing global common practice over many years. In 1996, ACCA pioneered the introduction of International Financial Reporting Standards (IFRS) into its global examination framework—almost a full decade before they were established as the guiding standards for European financial reporting in 2005. To enable those trained to national standards to develop international financial reporting expertise, ACCA offers a Certificate and a Diploma in International Financial Reporting. ACCA has also been actively involved in the unfolding debate on corporate social responsibility since 1990. ACCA was represented on the board of the Global Reporting Initiative (GRI) from its inception until 2007 and an ACCA representative now chairs the GRI's technical advisory committee.

Conclusion

In commissioning and disseminating this report, ACCA hopes that it can help support the CFO community in the United States as it moves towards international reporting standards. As developments unfold—particularly in the realm of IFRS—ACCA will be uniquely placed to comment and help guide CFOs in successful adoption of global reporting standards.

http://www.accaglobal.com/global_standards/