

NON-FINANCIAL INFORMATION IN ANNUAL REPORTS

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The emphasis placed on non-financial information by the United Nations Group of Experts on International Standards of Accounting and Reporting has aroused much interest and controversy. In contrast to the usual focus on financial matters by national and other international bodies concerned with the subject, the Group considered non-financial reporting „as important as financial reporting in appraising the operations of transnational corporations and their impact on and contribution to the countries and communities in which they operated.”¹⁾ More than three years have passed since the Group's report came out. Although the United Nations is continuing to deal with the issues raised and the recommendations made by the Group in the newly constituted *ad hoc* Intergovernmental Working Group of Experts,²⁾ following the recommendations of the Secretary-General, progress to date has been slow. The purpose of the present paper is to review the background against which the Group made its recommendations, evaluate major issues and considerations raised in them, and draw some conclusions as an aid to further work in this area.

The Background

The Intellectual Forerunners

The need for the disclosure of information on the state of affairs of corporations can be traced to the very beginnings of the special privileges accorded to them. If corporations enjoy limited liability and access to financial markets, there is a corresponding requirement for a degree of transparency in respect of their activities and circumstances. As the role of corporations has increased in national and international economic affairs, the demand for information from them has also increased. In particular, labor groups have been interested in knowing the labor policies and employment conditions of corporations. Environmentalists have been eager to monitor what corporations are doing about pollution and anti-pollution. More generally, questions have been raised about the fundamental objectives of corporate reporting. Given that corporations are profit-making entities, should they also have a social responsibility? In other words, should they be held accountable socially, and should their reports on their activities be responsive to the concerns of their constituencies? These constituencies are no longer limited to their shareholders and creditors but include their workers, the communities

¹⁾ United Nations, *International Standards of Accounting and Reporting for Transnational Corporations, Report of the Secretary-General and Report of the Group of Experts on International Standards of Accounting and Reporting* (New York, 1977), page 36.

²⁾ The Group was established by the United Nations Economic and Social Council, at its first regular session of 1979, in resolution 1979/44, with the following composition: nine members from African States; seven members from Asian States; six members from Latin America; nine members from Western Europe and other States; three members from Eastern European States.

in which they are located, their suppliers and customers, and government agencies. Even for shareholders and creditors, there is a presumption that the long-term performance of corporations has a positive correlation with their social performance, especially as perceived by the constituencies. For corporations must operate in a social environment, which is in turn affected by their actual and perceived social performance. There is, therefore, a case for a broad-gauged reporting system which will reveal the social performance of corporations. Correspondingly, there is also a case for a social audit, whether internal or external. A model corporate report can thus no longer be limited to financial items.

Discussions in the United Nations

It will be recalled that the issue of international standards of accounting and reporting was first raised at the United Nations in connection with the deliberations on the impact of multinational corporations on development and on international relations. This origin had three significant effects on the direction of subsequent developments.

First, the whole issue was discussed within the general framework of the then grave concern over the activities of multinational corporations. The theme of corporate accountability and social responsibility was much in evidence. There was great danger that the deliberations might degenerate into political rhetoric and confrontation. The consideration of concrete issues such as international standards of accounting and reporting was a great victory for those who believed in a positive orientation and role for the international organization.

Second, the same key members of the Secretariat who served the Group of Eminent Persons also served the Group of Experts on International Standards of Accounting and Reporting. They were intensely aware of social considerations. In the report of the Secretariat issued a year before the Group published its report, non-financial reporting had been suggested. The Group indeed organized its deliberations along the lines suggested by the Secretariat, including the establishment of a working group on the reporting of non-financial information.

Third, the discussions of the Group were further affected by its composition, which was not only high-level but also included persons with a background in labor. Although the members with such a background were a small minority, their influence was enhanced by two considerations. One was a general recognition of the desirability of having a labor input, especially since labor participation had been considered inadequate in connection with the Group of Eminent Persons. The other consideration was the general desire to reach a consensus rather than to put out a majority and a minority report, since the usefulness of a split report would be greatly reduced. Since non-financial reporting, including employment and labor, was dearest to those with a labor background, it was used as a bargaining tool to arrive at compromises over financial reporting. Non-financial reporting thus became inseparable from financial reporting in the negotiating process. The fact that the majority of the members of the Group were more interested in financial reporting resulted

in a tendency for the majority to pay more attention to the financial aspects and to make concessions on non-financial aspects.

The Key Issues

The recommendations of the Group of Experts have attracted a great deal of attention and comment. On the non-financial items especially, most commentators have regarded the recommendations as innovative but excessive.

Most of the comments and criticisms can be better understood if the backgrounds just outlined are borne in mind. More specifically, they may be grouped under five key headings, which will be considered one by one.

Why the United Nations?

Many commentators object to United Nations involvement in international standards of accounting and reporting. These objections apply especially to non-financial items. There are five underlying reasons. First, the United Nations is regarded as too big to be effective. Second, it is seen as being dominated by adversaries, especially anti-business groups. Third, it is considered to be too political. Fourth, it is felt that the work would be more appropriately left to the professional groups. Fifth, there is a duplication of work.

On the question of size, it is true that decision-making in a large organization is time-consuming and difficult. The size of the United Nations, moreover, has grown over the years.³⁾ Decision-making within the United Nations framework, however, does not mean that everything is considered by the General Assembly. Expert groups are usually kept relatively small, despite the need to allow for adequate geographical representation. Indeed, there is a parallel with decision making elsewhere. A democratic institution does not resort to referenda on every issue. The key question is whether a less representative body than the United Nations would be a better framework for establishing world standards. In the world of sovereign nations, the days of standard-setting without representation are numbered, if not completely over. This is why the United Nations is increasingly involved in global efforts, such as the law of the sea and the setting of statistical standards, as well as peace-keeping activities. By the same token, the United Nations does not supplant national and regional efforts. It profits from, complements, coordinates and synthesizes these efforts. Clearly, whatever standards might be established by less representative groups, such as the European Communities and the Organization for Economic Cooperation and Development, they could hardly be accepted as global without further consideration.

The question of dominance by the adversaries of the developed countries

³⁾ The United Nations General Assembly Hall used to have a centerpiece decorated with emblems, one for each member nation. With the explosion of the membership in recent years, the constant addition of emblems and their rearrangement made this architectural embellishment impractical. Consequently, the nations are now symbolized by a plaque representing one world. The symbol is significant, for there is only one United Nations organization, in which virtually all the nations are represented.

and their institutions, such as transnational corporations, is keenly felt by many developed countries. This is especially the case with matters relating to transnational corporations, since the third world countries, which command an absolute majority, have very little experience as homes for the corporations, and their reactions have often been colored by negative views of corporate activities. Even here, however, the influence of the third world can be exaggerated. First, as already mentioned, the relative strength of different groups of countries in the General Assembly does not reflect the actual strength in specific bodies. On technical matters, especially, the developed countries are often well-represented. The ratio of developed country representatives in expert groups generally exceeds that for the world assembly as a whole. Second, the use of the consensus procedure enables the developed countries to exercise an effective veto. Lastly, it should be remembered that resolutions passed without the support of developed countries are hardly ever effectively implemented, since the world organization is far from being a world government. The consensus of the powerful in the real world remains a prerequisite for effective implementation of virtually all United Nations decisions.

Apart from the fear of the wrong political slant and the loss of political control, the apparent predominance of political issues in the United Nations is a source of great unease for technicians. The injection of political considerations appears to be extraneous, unscientific and unprofessional. However, many issues in international standards of accounting and reporting are indeed important and controversial. Opinions often vary between nations and between groups. It is in this sense that these issues often assume political significance, internationally or nationally. So long as different approaches and positions exist for different interested parties, the subject matter is by nature no longer purely technical. At the same time, it is the consideration of increasingly technical questions, such as international standards of accounting and reporting, that will enable the United Nations to engage in activities which are not purely political.

A further reason why some critics object to the United Nations effort has nothing to do with the United Nations as such but is an extension of a general objection to government involvement. This is notably the case with United States accountants, who are anxious to keep the task of standard-setting in their own private hands. It should be noted, however, that the final authority for standard setting necessarily rests with the government. Any government, may, of course, delegate the function to professional or other private groups. Some governments are not in the practise of doing so. In international standard-setting, it is therefore essential to involve the governments or intergovernmental organizations.

Lastly, inasmuch as the standard is intended for the world as a whole, a less representative body has intrinsic limitations. At the same time, instead of leading to a proliferation of standards, United Nations work should introduce a measure of uniformity by coordinating and cooperating with relevant work being done elsewhere. The contribution of professional organizations and regional groups such as the European Community and the Organization of Economic Cooperation and Development, to the Group's work has been

strong. Indeed, international standards already promulgated by other organizations have served as the basis of discussion. A comparison of the recommendations by the United Nations Group with those of the International Accounting Standards Committee and the OECD guidelines indicates few conflicts.

Reporting or Accounting Standards?

Another criticism of the United Nations work is that it has placed too much emphasis on reporting or disclosure standards and has paid insufficient attention to accounting standards. It is maintained that, without some degree of harmonization in accounting standards, uniform reporting standards do not yield comparable information. I have argued elsewhere for a simultaneous attack on accounting and reporting standards.⁴⁾ Suffice it to say here that the identification of reporting standards need in no way conflict with that of accounting standards.

Minimum or Maximum Items?

Although a key approach in the work of the United Nations Group is the identification of lists of minimum items that should be reported, some critics have characterized the list as a maximum. It is true that, as far as the non-financial items are concerned, the list goes beyond existing requirements for general purpose reports. Whether some of the recommended items are indeed redundant can be best judged when each is examined in a subsequent section. Here it should be pointed out that not all the minimum items must necessarily be published in a single annual report. They may be included in supplementary reports which are made available to interested parties, as in the case of 10Ks in the United States. Further details may be placed on file with some government agency, or they may be made available on request, including appropriate charges for the cost of handling. It is admitted that the general thrust of the Group's work is somewhat ahead of the times. This is deliberate, since a significant time-lag can be expected between a proposal by an international group and its translation into reality.⁵⁾

Some, however, consider the inclusion of non-financial items whether few or many, inappropriate. This arises first from the unfamiliarity of many accountants with those items. Indeed, there was a great deal of discussion by the United Nations Group as to whether these items should be labeled „non-financial“, „socio-economic“, etc. The division between financial and non-financial items was made deliberately, precisely because accountants have special competence in the former but not necessarily in the latter. A clear division between the two helps to allay the possible fears of accountants who find themselves in unfamiliar territory, even though some of the non-financial items can be, and sometimes have been, incorporated into financial statements.

⁴⁾ Cf. N. T. Wang, „The Design of International Standards of Accounting and Reporting“, *Journal of International Law and Economics*, Vol. II, No. 3, 1977; „A Third World Challenger to Multinationals“, *Accountancy Age*, December 7, 1979, pages 16-18.

⁵⁾ For example, the proposed Fourth Directive of the European Community dealing with company accounts took a decade to be negotiated, and when it is finally adopted as revised, it will take another two and a half years before it is reflected in national legislation and company reports. Given the general movement of events, unless proposals are forward looking they will be obsolete before they are seriously considered.

A related objection to non-financial items is that they are too complex and untested. As far as complexity is concerned, this undoubtedly applies to many financial items as well. The degree of complexity varies with the environment in which corporations operate. For example, appropriate currency translation becomes more complex when a flexible exchange regime replaces fixed exchange rates. Similarly, when external risk is significant, the financial items which will measure risk exposure become more complicated. At the same time, the degree of complexity for non-financial items is exaggerated by a direct link between reporting on these items and the measurement of overall social performance and even moral judgment. It is further exaggerated by confusing the general purpose annual report with special purpose reports on such matters as working conditions in, or the environmental impact of, specific facilities. In fact, non-financial items for general purpose reporting must by nature be fairly broad and not very detailed.

Moreover, an important characteristic of most of the non-financial items recommended is that considerable latitude in reporting is left to the corporation. For example, with respect to environmental measures, no more than a „description of types of major or special environmental measures carried out, together with cost data, where available” is proposed. This is far from being a demand for detailed environmental impact studies for every plant. Instead, a few descriptive paragraphs will generally be adequate.

This non-comprehensiveness and the great latitude allowed have elicited objections that such reporting merely serves the purpose of public relations and self-congratulation. On the other hand, the comparison should surely be between non-financial reporting that follows some standard and that without any standards. The chances for self-serving reporting are undoubtedly much greater in the latter case. Moreover, because of the unfamiliarity with, and lack of experience in, non-financial reporting, a period of education and experimentation is desirable before more specific requirements become generally accepted. The very identification of the categories and items would serve an educational function for top management in formulating policies on such matters as environmental protection, or health and safety standards for workers. Greater precision in definition and classification can be attempted as experience is gained.

Competitive Disadvantage?

One major objection to the disclosure of non-financial items as recommended by the United Nations Group is that such disclosure would entail a competitive disadvantage. Three possible reasons for such a disadvantage should, however, be distinguished.

First, it is often thought that the disclosure standard would apply to transnational corporations only and not to national corporations. In fact, the Group was explicit in ruling out discrimination between transnational and national corporations, since applicability is defined by a size test rather than by the degree of transnationality.⁶⁾

⁶⁾ United Nations, *International Standards of Accounting and Reporting for Transnational Corporations* (New York, 1977), page 47.

Another reason for competitive disadvantage is that disclosure requirements might not be implemented by some competitors. This would apply, for example, where requirements were either voluntary or not enforced. The argument should not apply to a truly international standard which is backed by national legislation and enforcement procedures.

A third reason for competitive disadvantage is that the information may be sensitive. Disclosure is considered disadvantageous even if uniform disclosure applies to every corporation. Here the principle of confidentiality is indeed accepted by the United Nations Group. The need for confidentiality, however, depends on the specific items concerned, as will be examined later. On the whole, the boundary of confidentiality has been extended over the years. As in the case of some government bureaucracies, traditional rules of secrecy frequently lead to virtually all information being considered top secret. Disclosure has improved over the years, as attitudes about the costs and benefits involved have changed.

Costs and Benefits?

In the final analysis, the costs and benefits of disclosure must be carefully balanced. The admission by the United Nations Group that it had not analyzed the costs in relation to the benefits was seized upon by some as evidence of a fundamental flaw in its recommendations. In this connection, three points should be made.

First, in evaluating the costs and benefits of most of the regulatory or social programs, calculations are often imprecise and judgment is unavoidable. This is true also of financial standards promulgated by national or international bodies. Rarely is it possible to quantify all the direct and indirect costs and benefits of alternative proposals. The best that can be done is to consider all points of view, investigate thoroughly and experiment cautiously.

Second, in considering the costs and benefits, a distinction must be made as to whose costs and benefits they are. As pointed out earlier, for many non-financial items, most of the costs appear to be borne by the reporting entities while the benefits appear to go to society, if not to the corporations' adversaries, such as labor unions, and environmental and public interest groups. An alternative view is that the long-run viability of a corporation may very well be related to its ability to communicate with its constituencies on the matters that they are most interested in. Moreover, non-financial reporting can also be used as a vehicle for putting across the corporate point of view. For example, a corporation may show how costly it is to abide by particular environmental regulations. In one case, it was shown that using a particular device to control pollution at the plant level could consume so much power that it would result in a net increase in pollution for the country as a whole.

Third, a distinction must be made between costs in the short-run and those in the long-run. If all the new standards were to be introduced overnight, the costs to the corporations of gathering and systematizing the additional information could be high. For accounting firms, the large investment in the existing information infrastructure could be rendered obsolete. However, if the actual implementation is gradual, which is likely to be the case, the cost decreases considerably. Indeed, to the extent that the various national

requirements are harmonized, the ultimate effect for the corporation, as well as for society as a whole, should be cost-reducing.

The Five Non-Financial Areas

The foregoing has already touched on some of the areas of non-financial disclosure requirements identified by the United Nations Group. An examination of each of the five areas will throw further light on the issue involved.

The fact that only five areas are identified demonstrates that the approach is not intended to be comprehensive, as some of the social accounting or social audit literature might suggest. For example, because of the importance of energy in recent years, some governments require corporations to report on energy-saving devices introduced. Although this may be related to the environmental reporting recommended by the Group, it is more specifically focused on such considerations as national security and balance of payments.

A comparison of the recommendations of the Group with those of its interim report reveals considerable simplification and finer tuning from the earlier document. This is because many of the comments on, and criticisms of, the interim report made by various groups were accepted. Much of the criticism leveled at the interim report, therefore, does not apply to the final report.

Labor and Employment

1. Enterprise as a Whole

- a. The requirement of a description of „general corporate labor relations policy” is sometimes considered impractical because corporate policies depend on local law and practice. Here the key word is „general”. For example, a statement may be made on whether trade unions are recognized for collective bargaining purposes or whether there is no discrimination on grounds of race, color or sex. Such a statement represents a generalization of corporate policies, rather than an exhaustive description in each locality. Exceptions to the rule in particular localities may, of course, be stated. For example, labor policy in countries embracing apartheid may deviate from the general practice.
- b. Regarding the requirement to disclose the total number of employees at year end, there is general agreement that this is both desirable and feasible. Questions arise as to whether a breakdown by geographical area is needed. It is significant, however, that geographical area is typically undefined and is to be distinguished from country by country data. Moreover, breakdown by line of business is suggested only if it is considered feasible.

2. Individual Member Company

The list of minimum items in this area is much longer for individual member companies than for the enterprise as a whole, in recognition of local variations. Questions have been raised as to whether a uniform

format concerning classification schemes might not lead to misleading comparisons. However, the same argument applies in respect of most international social and economic statistical comparisons. There is no substitute for meticulous care in interpreting international comparative information. Just as in socio-economic statistics, however, careful international negotiation of international standard classifications, based on the exchange of country experience, should remove the more blatant discrepancies in international comparisons.

Production

1. Enterprise as a Whole

a. The requirement to report on „physical output by principal lines of business in accordance with normal industrial practice” clearly recognizes significant industry variations. Car manufacturers, for instance, generally report the number of passenger cars and trucks produced, even though there are important quality differences in each category. For many multi-product firms, such as chemical manufacturers, the number of products could run into thousands. Evidently, the emphasis here is on principal lines of business only.

Concern has been expressed that, for some industries, such a breakdown could be competitively sensitive. So long as it is up to the industries to judge what the principal lines are, in accordance with their normal practice, this should not be a serious problem.

The requirement for „description of significant new products and processes” has given rise to similar concerns about competitive sensitivity with respect to new processes. It is not suggested, however, that engineering details should be revealed in such a general description. Even companies which describe new processes in some detail should know how to protect confidentiality.

2. Individual Member Company

In addition to the requirements applicable to the enterprise as a whole, a further requirement is „description of practices regarding raw materials and components”. The main intent here is to show the extent to which the company relies on foreign or domestic sources. Another requirement refers to „average annual capacity utilization in accordance with normal industrial practice”. Although such information is sometimes regarded as competitively sensitive, the main situation of companies is generally known to industry circles and is frequently indicated by corroborative data such as employment, shipment, sales and inventories.

Investment Program

1. Enterprise as a Whole

For these three requirements, namely, „description of announced new capital expenditure”, „description of main projects, including their cost, estimated additions to capacity, and estimated direct effect on employment in the enterprise” and „description of announced mergers and takeovers, including their cost and estimated direct effect on employment”, concern has been expressed about the sensitive nature of

cost figures. It should be noted, however, that the definition of a project is left to the discretion of the enterprise concerned, and costs are not broken down in detail.

2. Individual Member Company

There is no significant difference in the requirements or the issues raised as compared with enterprise as a whole.

Organizational Structure

The requirements for:

„description of management structure, e.g., degree of centralization for decision making”;

„names of members of the board of directors and, where applicable, the supervisory board of the parent company and a description of their affiliations with companies outside the group” and

„number of owners or shareholders, and where known, the names of the principal owners or shareholders” do not give rise to any particular difficulties.

Environmental Measures

The requirement for „description of types of major or special environmental measures carried out, together with cost data, where available” is generally recognized as very broad and flexible.

Conclusions

The foregoing considerations have important implications for future policy directions. The points are summarized below.

1. Because of the proliferation of national and international activities related to standard setting, the coordination and harmonization of international standards of accounting and reporting at the international level is needed.
2. The reasons for including non-financial information in corporate annual reports are the importance and complexity of corporate activities and the broad interest in presenting a true and fair picture of the state of affairs of corporations. There is no fundamental objection to the inclusion of non-financial items as such.
3. Most of the objections to requirements for non-financial information have a historical origin, in that the proponents were, or were perceived to be, largely special interest groups who were anti-business. Once the matter is taken up seriously, leadership should be assumed by the main stream, including the accounting profession, the governments of the home countries of transnationals, and the corporations themselves.
4. In international negotiations, the future problems may be the reverse of the problems experienced in the initial stages. As negotiations become more technical and less rhetorical, many of the third world countries who were the initial supporters of the effort may lose interest, partly because there appears to be little political mileage to be derived from such negotiations and partly because of their lack of technical expertise. In their own interest, the developed countries would do well to keep the issue alive internationally.

5. In spite of the sharp criticisms sometimes leveled at the non financial recommendations of the United Nations Group of Experts on International Standards of Accounting and Reporting, most of the recommendations have already withstood the test of searching inquiries. They should serve as a useful basis for further negotiations.
6. Although most of the substantive criticisms of the Group's recommendations have complained of their excessive coverage or detail, a close examination reveals that, as a result of many compromises, most of the requirements are couched in very broad terms and left largely to the discretion of the enterprises themselves. Further revisions and improvements should guard against criticism from the opposite direction, about excessively general and vague formulations which would impair the fundamental purpose and uses of reporting.