

# Balancing Performance, Ethics, and Accountability<sup>1</sup>

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**ABSTRACT.** Practical mechanisms for aligning performance, ethics, and accountability are urgently needed. The context for this includes the organisational, technological, and regulatory transformations underlying current patterns of globalisation. These factors, combined with the associated emergence of civil action concerned with corporate accountability and deeper value-shifts, make such realignments a practical possibility.

Social and ethical accounting, auditing, and reporting provides one of the few practical mechanisms for companies to integrate new patterns of civil accountability and governance with a business success model focused on deepening stakeholder relationships around core non-financial as well as financial values and interests.

Experience over the past decade has enabled viable and effective methods to evolve and to lay the foundation of “standards-in-practice” against which future accounting, auditing, and reporting, will be benchmarked. Institutions are emerging to regularise this arena of actions, in the first instance through voluntary codes and process standards.

A number of challenges exist in securing social and ethical accounting and auditing as a legitimate and effective framework within which organisations can achieve an appropriate balance of financial and non-financial interests, aims, actions, and outcomes. The emerging experience, expertise, methodologies, and institutions provide the basis for these challenges to be effectively met.

## Why ethics?

### *The inclusive company*

The emergence of social and ethical accounting, auditing, and reporting as a common practice within the corporate community is likely to have

a major influence on the competencies, direction, and basis of viability of companies as we move into the next century. It may also enhance the corporate sector’s positive social, ethical, and indeed environmental impact – but, then again, it may not.

To understand the emerging pattern of social and ethical accounting, auditing, and reporting (SEAAR), and its possible range of substantive effects, requires first that one appreciates *why* there is a burgeoning interest in the field, and from that gain some understanding of *what* approaches to SEAAR are emerging as best practice today, and how this experience is likely to shape up in the future.

It is useful to start with the age-old question, “why ethics?”. What may be expensive procedures and processes to understand social and ethical performance are not taken on lightly by any organisation. Most companies faced with the pressure to show healthy financial returns will want to see new activities contributing to, or at least not significantly detracting from, financial profitability.

One answer to the question of “why ethics?” is that the business community is recognising the value of, and is responding to increasing concern about, its ethical performance. The Royal Society for the Arts study, “Tomorrow’s Company”, examined what kind of companies are likely to be successful in tomorrow’s business climate.<sup>2</sup> In the study report, a number of Chief Executives set out a vision of their own companies. Typical of these visions is that of the Group Chief Executive of Grand Metropolitan, George Bull:

Increasingly, business people are recognising that

their prosperity is directly linked to the prosperity of the whole community. The community is the source of their customers, employees, their suppliers and, with the wider spread of share ownership, their investors.<sup>3</sup>

The study concluded that tomorrow's company will be "inclusive" in forming deeper relationships with key stakeholders as a means of achieving financial success. Here then is the "stakeholder economy" espoused by such contemporary figures as the British journalist and economist, Will Hutton, and the Prime Minister of the United Kingdom, Tony Blair.<sup>4</sup> This view is then that the company which ignores its stakeholders does so at its peril, and that similarly those who take them into account will form the bedrock of an inclusive society.

Professor Henk Van Luijk and others from the European Institute of Business Ethics (EIBE) reinforces this perspective in summing up the business case by drawing a link between inclusivity and reputation:

High ethics companies such as Texas Instruments, IBM, or Marks and Spencer . . . know that behaving ethically is integral to their success. They know that their reputation – a reputation for fair dealing, which gains them the trust of their customers, suppliers, and the community at large – is crucial to their bottom line.<sup>5</sup>

This view conforms with an increasing number of studies into the foundations for successful business, whether for the multinational or the corner shop: *reputation counts*.<sup>6</sup> Relationships matter in seeking business success. Values-in-action that results in trust, integrity, and commitment are integral to making long term relationships work, and hence also profitable.

#### *When do people care*

The argument underlying the simple "inclusive company" approach is that: "Deepening relationships is good for business; deepening relationships means being good to each other; Good business is therefore about being good to each other." This argument is, to say the least, prob-

lematic. This is not because it cannot be right, and is certainly not because it should not be right. It is a problem because it often is not right in practice in the short run, and the short run (as John Maynard Keynes pointed out) can last a hell of a long time.

Companies can and do seek to profit from doing things that are deemed negative by society, such as making people unemployed, damaging the environment, behaving in corrupt or underhand ways, and selling products which harm people. The case of tobacco companies making profits by producing products which kill some of their customers and undermine the health of the rest, is an extreme, but poignant, demonstration of this fact. Less melodramatic but equally significant is the simple fact of companies increasing profitability through making people unemployed (as opposed to companies having to shed labour to survive, which is not at all the same situation, although it is often presented as such). As the Institute for Policy Studies reports, whilst annual worker layoffs across the U.S. corporate sector increased by 39% between 1990 and 1995, corporate profits over the same period increased by 75%.<sup>7</sup> As the editors of the magazine, *Business Week*, concluded:

It doesn't take a brain surgeon to see why millions of people who worked hard to make their companies competitive feel shafted.<sup>8</sup>

Behaving in ways that in most situations to most people would seem "unethical" *can* pay, at least in the short run, if stakeholders do not penalise the company through, for example, lower staff productivity, lower consumer interest, or investment realignments.

It is therefore problematic to argue the view that the "inclusive" company is *necessarily* a more profitable business model. It is certainly true in some cases. For example, the Centre for Tomorrow's Company together with the merchant bank, Kleinwort Benson, have argued that what they deem to be "inclusive" companies from the FTSE100 tend to perform better financially. However, to argue on this basis either that inclusive companies are "good to people" or that only inclusive companies will survive, is clearly either wrong or in some sense tautological.

What we can say, however, is that the ethics of a company influences its business performance when stakeholders who count say they that should. “Business ethics” can only become a reality if stakeholders that do or potentially have leverage over a company’s business performance – which might include managers, directors, and shareholders as well as the “political consumer” – decide that their views need to be heard and taken into account. The fascinating and central questions then become: “when do people choose to care, why, and what do they do about it”.

There is growing evidence that the failure to behave ethically in the eyes of key stakeholders can and in cases does pose a threat to the financial health of some companies.<sup>9</sup> This is particularly the case with retail companies who are potentially vulnerable to direct consumer action. A recent study commissioned by the Co-operative Wholesale Society in the U.K. highlighted the rise in “ethical” or “vigilante” consumerism.<sup>10</sup> The survey of a sample of 30,000 of their food retail customers found that:

- ✓ 35% answered “yes” to the question, “Have you boycotted any product because you are concerned about animal rights, the environment, or human rights”.
- ✓ 60% answered “yes” to the question, “In the future, would you boycott a shop or product because you are concerned with these issues”.

Now clearly the results of “quicky street surveys” should be treated with care – it is a little like asking someone whether they think ethics is good. However, substantive practice seems to back up the view that these figures, if not quantitatively correct, are broadly accurate in identifying the basic pattern of response. There is growing evidence that people respond positively to a more ethical stance being adopted by companies, as witnessed by the success of companies such as the Co-operative Bank and The Body Shop in the U.K. to attract customers and high quality staff on this basis. Similarly, the willingness of very mainstream companies to respond to “consumer ethics” suggests that their own, highly sophisticated research suggest that the “ethical effect” is not to be taken lightly.

Attempts by companies to “keep their heads down” have more recently met with plummeting returns, as corporate responsibility initiatives, and the sophistication of the organisations managing such processes, has increased. As Shell discovered to its cost over first the Brent Spa fiasco, and then through the disclosures over its approach to business in the Ogoni region of Nigeria, the views either that social and ethical performance can remain private or that the public do not care about what happens beyond their backyards, are both very wrong. Furthermore, companies are finding themselves victims to the excesses of their competitors. Shell’s revealed performance in Nigeria led quickly to a far higher profile of the campaigns against the activities, for example, of the French oil company Total in Burma, and of British Petroleum’s operations in Colombia. The consumer campaigns launched at particular textiles and toys companies regarding labour standards of their suppliers in the “South” (the “third world”) has now cascaded across key sectors that sell retail products produced in the South, textiles, sportswear, toys, food, and flowers.

The consuming public is clearly an important, but by no means only, stakeholder group whose ethical views may encourage companies to rethink their approach to doing business. In a recent seminar held for a major oil company, a senior staff representative offered the following view:

The company has downsized in recent years with massive redundancies. You have to understand that people are disillusioned and frustrated. They cannot be driven to work harder through fear alone – they need to know that the company does care, and does hear what they are saying, even although we all know all about business imperatives. The view that staff are disposable will eventually make for a disposable company.

The British standards organisation, Investors in People (IIP), have for long argued that high productivity requires committed staff, which in turn requires a company that can earn that commitment. In offering evidence to support this assertion, IIP has sought to show that companies which have gone through the IIP process of staff consultation, staff-related systems and procedures

development, improved staff training, etc, simply perform better in financial terms, whether measured in terms of return on capital or pre-tax profit.

So the corporate sector has good reason to show concern for its social, ethical, and environmental performance. Beyond any possible personal views of managers and investors that companies do indeed have a social and ethical responsibility, there is the more hard-bitten view that social and ethical responsibility is good for business. It consolidates market positions, or at least protects the business from public interest campaigning, and it can also strengthen the solidarity, commitment, and productivity of a company's staff (and also, by extension, the productivity and quality of its suppliers and advisors).

#### *Globalisation and technological drivers*

The argument that "relationships" count is of course not new. What is new, however, are the economic and social conditions under which this most recent cycle of thinking and practice is happening. Most important are the organisational and market changes associated with contemporary developments in technology and the process of globalisation.

With respect to the former, we are seeing the most radical shift in the manner in which commerce is organised since Taylorian mechanics entered our organisational vocabulary. The downsizing and flattening of the main rump of most organisations, and the dispersal of many of their core functions into market networks through, for example, franchising and outsourcing, all raise new demands with regard to quality at every level. The combination of technological developments in the area of computing and communications – and increasingly their relationship – has vastly reinforced the tendencies towards "functional dispersal", whilst at the same time tightening market and cost-based competition in such a manner as to place enormous pressure on the need to make these dispersed operations work at their peak of possible performance.

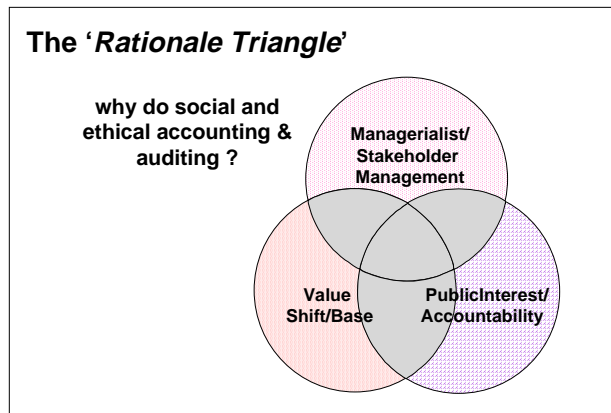
Globalisation has both enabled and driven

these tendencies further. Opportunities for cost reduction and accessing new markets through physical and cultural extensions of the business process has placed further pressures on the traditional business unit. For example, this has focused the source of value-added and profit on supply rather than production, and brand rather than product leadership. Globalisation, however, has not been only the prerogative of the corporations. Civil groups previously focused on narrow local or perhaps national agendas have increasingly found voice at international levels through taking advantage of the same rack of technological and organisational shifts, and by seeing how to challenge the globalised brands by "ethical intermediation", for example, by showing people in Europe what a company is doing in Latin America.<sup>11</sup>

A "stakeholder-based company" that is able to build trust and integrity into its key relationships thereby lowers the cost of establishing and maintaining increasingly complex networks of suppliers, franchisees and agents, physically dispersed staff, and indeed multiple levels of actual and potential regulators from the local town council to the World Trade Organisation. A stakeholder-based company is one that in many respects is most fit to take advantage of the technological and regulatory changes that underpin and enable the globalisation of trade, production, and marketing. A stakeholder-based company, however, is also one that has come to grips with their changing civil environment.

#### *Non-instrumental values*

It would be unfortunate to attribute all interest in "ethics" to the instrumental reasoning of profit-oriented managers operating in increasingly complex and competitive markets. Anyone working with the business community will have been impressed by the commitment of many people working within this community to improving the social and environmental footprint of the companies in which they work. The announcement by British Telecom (BT) in December 1996 that it intended to undertake a comprehensive "ethical audit" was welcomed



The *Managerialist* Rationale: that to survive and prosper in society, business needs to know what is happening, what people think about them, and how best to influence those perspectives. At the simplest level, this speaks to the need for good market research and public relations. At the more sophisticated level, this highlights the need for managers to have a broader understanding and appreciation of stakeholder needs and views, and the patterns of demands on business that are likely to arise in the future.

The *Public Interest* rationale at the second end of the triangular spectrum concerns the ability of society to make business respond to changing interests and needs. This *public interest* perspective emerged particularly in the 1970s, but has become institutionalised more recently in the growing ethical consumer and investment movements. Here, businesses are not merely *choosing* to undertake some form of social and ethical accounting, auditing, and reporting as a means of understanding and manipulating their social environment, but are rather being forced to respond to demands from the actors that make up that environment.

The third corner of the triangle is the most contentious, since it refers more to a *Value-Shift* in business than a compliance or managerialist-based response to new pressures. Here lies the view that business can evolve and take on a different historic role in society, at the same time as the roles traditionally taken on by the state are increasingly under threat. Leaders are tending to question the *raison d'être* of their company's and their own activities and are searching for an expanded repertoire of explanations and measures of success that are provided by the bottom line.

with some astonishment by those campaigning for greater corporate accountability. BT is certainly not a much-loved company, but was under no particular pressure at the time to take this step. The more cynical commentators pointed to BT's interest in gaining from its regulator, OFTEL, increased room for new commercial initiatives, and also the possible link between this commitment and the subsequent move by BT to form a global alliance with MCI. The commitment to an ethical audit may indeed have improved BT's relationship with both the government at the time and the in-coming Labour government. However, there is little doubt that a major factor behind the decision was the personal interest and commitment of BT's leadership. Ethical leadership is not the prerogative of the public and private non-profit sectors.

At the same time, such leadership tends to flounder unless it can anchor its arguments to, and practice within, a sound business model. As David Korten argues, any company that seeks to behave ethically against the flow of competitive pressures and sources of profitability will tend to be penalised by the market, either through a loss of market share arising from reduced competitiveness, or through the financial markets, or – most probably – both.<sup>12</sup>

Ethical leadership can, of course, change the terms on which profitability is secured throughout the market, and thereby offset the dangers of reduced competitiveness through "ethical innovation". For example, it is unlikely in today's climate that a clothing retailer could improve its market position by cutting costs through the exploitative use of child labour. On the other hand, companies are increasingly pointing out to their customers, staff and other stakeholders where they have chosen to invest in the education or health and safety of people working for them. Similarly, most mass-consumer body and hair care products are now explicitly not tested on animals. These developments are a tribute in part to the decision by particular companies such as Levi Strauss and The Body Shop International to lead the way in introducing a new ethos in a particular aspect of the way business is done. This is true irrespective of why these companies made such decisions.

### Why measure it?

Companies need to know the social, ethical, and environmental views of stakeholders who do count. They also need to know how these views are changing over time, and how they are likely to determine attitudes and actions by stakeholders – whether individual or collective – towards the company. Thus, companies seek to measure and disclose their social and ethical performance in order:

- ☑ to understand what they are trying to achieve and how best to measure performance against their aims;
- ☑ to know what they are doing;
- ☑ to understand the implications of what they are doing;
- ☑ to understand in what ways if any they can explain their actions to increasingly sceptical and aggressive stakeholders.
- ☑ to understand whether there are practical options for improving their social performance in ways that will not harm their business performance, and may in many cases improve it.

The recent report on corporate governance published in the U.K. as a follow-up to the Cadbury report – the Hempel Report – made absolutely clear the need to count non-financial dimensions of business activities,

Directors should maintain and review controls relating to all relevant control objectives, *and not merely financial controls*.<sup>13</sup>

Surely, you might argue, senior managers at least *know* what they are doing? The worrying answer to this is: not always, and often not in critical areas where “soft” information is required. In one recent internal seminar run for a major multinational, an overhead was shown of an article about people demonstrating against the employment of child labour. The seminar’s facilitator laughingly said, “of course, you don’t do this sort of thing”. A nervous silence was followed by one of the more outspoken participants blurting out:

But that is the whole point. We don’t know. This

whole downsizing and decentralisation has meant that we no longer get information about these sorts of things. And even if we did, we would never get a chance to look at it, or do anything about it.

This proved a prescient statement. Just a few months later, the company was subjected to an aggressive challenge in the national press over its social, ethical, and environmental record in and around one of its major facilities in the South, a facility that had the reputation *within* the company of having “best practice” community relations and environmental programmes.

Managers need to understand the factors which influence their company’s performance. These include an increasingly complex matrix of non-technical, non-financial factors – exactly the kinds of factors which they and their companies are ill-equipped to find out about, and even less equipped to understand. Hence the “Tomorrows Company” initiative concluded:

tomorrow’s company is able to develop a framework of measurement that . . . will include financial components but will also feedback on the values (and) the health of key relationships.

### *Understanding climate rather than weather conditions*

This is not just a question of more market surveys covering a wider range of issues. Shell has been supporting environmental issues for several decades, and until the Brent Spa fiasco was seen as a reasonably “green company”. No amount of traditional market research would have been likely to predict the public response to Greenpeace’s call not to sink the Brent Spa. Similarly, it is very unlikely that the managers of toys, sportswear and textiles companies in the late 1980s would have believed that the consuming public would respond as they have in the last couple of years to concerns about labour conditions in suppliers in the South. After all, they would have argued, it has always been this way, and consumers benefit from poor labour conditions in terms of cheaper products. The evolution of people’s ethical positions are, perhaps

thankfully, not purely guided by such thoughtless logic.

Companies are increasingly realising that merely asking people their opinion about things does not reveal the dynamic process of how and in what directions people develop their thinking on the basis of deeply rooted values. “Counting” in the traditional sense of polling people’s views may work in choosing between different flavours of ice-cream, but it rarely helps in understanding how people develop a sense of moral concern, and how this concern is voiced. Understanding stakeholder’s views requires much more than simple survey work. Some deeper social contract is needed to go beyond inaccurate counting to a point where stakeholders begin to feel that their views count.

Companies understand now that they need to understand the “climatic conditions” that underpin people’s values if they want to be able to predict how they will respond to any particular situation. This has dramatic implications. In moving away from the conventions of traditional market surveying that do little more than observe the “weather” at any point in time, companies are faced with a far more complex dynamic that can only really be understood if they actually engage and gain people’s trust.

So companies understand now the need to “count ethics”. Most importantly this is to understand things that are going on that were not previously considered important to the daily life of a busy manager. What follows from this acceptance of the need to measure is the realisation that conventional approaches do not always work. Measuring turns out to be far more than a purely “subject-object” phenomena, a “we measure it” situation. It turns out that insofar as measuring is about understanding the deeper patterns that inform people’s attitudes and actions, alternative approaches to measurement are needed.

### **But why disclosure?**

Companies are finding in a growing number of cases that they need to respond to stakeholder concerns not only by changing their practices, but by being more open in reporting how they

have performed against key social, ethical, and environmental criteria.

For stakeholders to be willing to offer insights into their own deeper interests and concerns, they need an environment of trust and honesty. This in turn means that managers have to think quite differently about what they need to reveal about their own operations and practices. It is not possible to demand commitment from employees where the future of their own jobs is shrouded in secrecy. Suppliers are less likely to comply with codes of conduct imposed by their prime clients where they sense that these companies are less than concerned and even less open about their own behaviour. Consumers will simply not believe anymore the claims of companies without a more systematic, rigorous approach to disclosure.

Companies seek to influence public perceptions as to their social, ethical, and environmental performance. Whilst this is a task that all companies take to with considerable relish and vigour, the ways in which they have done this has generated considerable scepticism and indeed cynicism towards corporate claims of good behaviour. Despite a veritable outpouring of information from companies about their social, ethical, and environmental performance, there is ample evidence to suggest that stakeholders rarely believe what they are told by companies, certainly not beyond basic technical product-related information.

The clothing retail chain, The Gap, understood this when it agreed to adopt a code of conduct covering the factories in the South from which it purchases the products it sells. It understood that its customer base was open to being influenced by the growing number of non-profit organisations campaigning around labour conditions in these factories, particularly those focused on the emotive issue of child labour. The Gap, furthermore, along with an increasing number of companies throughout the clothing, sportswear and toys industries, have also come to accept that those stakeholders who are willing to penalise them for not behaving according to norms that they consider acceptable want “proof” that they are keeping their promises. The fig leaves of codes of conduct are in themselves not enough.

What is in addition demanded are reports of performance against these codes, externally verified by organisations in which stakeholders believe.<sup>14, 15</sup>

Reporting on social and ethical performance is not, therefore, only a matter of disclosure. It is an integral element of the process of communication between the company and key stakeholders. In this sense, reporting is a way in which stakeholders can see if the company “listened” to their concerns, and over time whether they have responded in practical terms. Further, reporting is an essential element of the process of deepening the understanding of managers as to what is going on and how people view it. Reporting, seen in this sense as a link in the chain of events that secures high quality feedback, is an obvious requirement. In conclusion, therefore, reporting is essentially an element of the communication, dialogue, learning, and decision-making process, rather than the endpoint in a retrospective analysis.

### **A side note on silent reporting**

Companies are of course accustomed to adopting an extensive array of procedures, including a range of forms of “accounting and auditing”. Financial accounting, for example, started originally because of the need for managers to have some basic records of cash flows, to provide a means whereby shareholders could hold the stewards of their investments to account, and as a means of working out how to divide the profits at the end of the day. It was only subsequently that the requirement to audit accounts became enshrined in law, principally as a means of protecting shareholders against unscrupulous managers and directors of the companies that they had bankrolled.<sup>16</sup>

Financial accounting was (and is still) therefore seen as a tool for seeing how the organisation was doing, for being accountable to one particular stakeholder group – the shareholders – and for working out who should get what share of the financial surpluses generated by the company. Auditing was similarly seen as a means of ensuring that the financial accounts reported

to shareholders (and subsequently the government for regulatory and tax purposes) were accurate.

Environmental assessment was extremely rare only a decade ago, but now is common practice by increasing numbers of companies. A recent survey carried out by the International Institute for Industrial Environmental Economics at Lund University, Sweden, concluded that 23% of Europe’s largest companies in 1995 produced some sort of environmental report, compared to 15% in 1993.<sup>17</sup>

The reasons for companies being willing to undergo such exercises varies to a considerable degree, as does therefore the content and form of environmental assessment. One reason concerned the acquisition of knowledge to enable the avoidance of legal liability, and in some cases to avoid confrontation with increasingly assertive and effective environmental campaigning organisations. Over time, the more positive business case for environmental auditing, as distinct from simply environmental reporting has for many industries and contexts been proven many times over, particularly the “win-win” arguments for cost-savings through eco-efficiency measures.<sup>18</sup>

Unlike in the financial sphere, statutory regulations guiding environmental accounting and auditing are not yet common. In Europe, for example, the Eco-Management and Audit Scheme (EMAS) is set out in non-mandatory legislation, and has been adopted and advocated as a “best practice” standard by the European Commission. As such, it is gradually being taken up by an increasing number of companies operating in Europe.<sup>19</sup>

A range of quality assurance systems have been developed over the last two decades to meet the needs of large organisations to organise and rationalise their change processes to achieve the maximum possible quality throughout their operations. Possibly the most well-known of these has been Total Quality Management (TQM), arguably (as its name suggests) the most comprehensive approach developed to date. What matters here is not so much the details of how or whether TQM works in practice, but that it is an entirely voluntary process completely devoid of any external pressure, such as campaigning

organisations in the case of environmental performance.

The widespread adoption of TQM and other system-level quality assurance systems (such as ISO9000 and BS5750) by parts of the corporate sector illustrates the fact that companies *will* commit considerable resources to securing the information required to know what is going on in a systematised manner. It is worth noting, furthermore, that approaches such as TQM include not only quantitative “output” data such as the technical failure rate of a particular product or process, but also subjective “outcome” data, such as the views of staff or indeed of the wider public of the organisation.

So it turns out that companies invest heavily in procedures and processes that yield complex sets of quantitative and qualitative, and objective and subjective, data covering issues both within and outside of the organisation. From this perspective, social and ethical accounting, auditing, and reporting is not a “future proposition”, but a reality today. Professor Rob Gray from the Centre for Environmental and Social Accountancy Research at the University of Dundee alludes to the existing although dispersed forms of existing social and ethical accounting, auditing, and reporting as “silent accounting”.<sup>20</sup> All companies today, he argues, *particularly* the larger corporations, are already offering ever-

increasing volumes of information about their social, ethical, and environmental performance, albeit in a fragmented form, of varying quality, and often with quite inadequate or at least unclear levels of external verification.

This should of course, hardly be surprising, since it is precisely these combinations of views and facts that make or break a company at the end of the day. Indeed, it turns out that a major reason for mainstream company’s increased interest in social and ethical accounting, auditing, and reporting is exactly to cope with the increasing complexity of their situation and associated management processes. As one senior manager of a major oil company said during an internal seminar introducing the topic:

We are having to cope with so many different quality issues at the same time, some technical, but many of them dealing with “soft” issues. If social auditing helps us to deal with them more rationally, then we really could use it.

So whilst companies love to hate procedures because of their time and financial costs, the most sophisticated and widespread systems have been developed for use principally by the business community, particularly larger-scale corporations. So the key issue becomes more than a question of “how to do it” in a cost effective way.

Silent reporting by companies in U.K. company annual reports

Voluntary	Required Mandatory
<ul style="list-style-type: none"> <li>✓ Environmental protection;</li> <li>✓ Energy saving;</li> <li>✓ Consumer protection;</li> <li>✓ Product safety;</li> <li>✓ Community involvement;</li> <li>✓ Value-Added Statement;</li> <li>✓ Health and Safety;</li> <li>✓ Racial &amp; sexual equality;</li> <li>✓ Redundancies;</li> <li>✓ Employee training;</li> <li>✓ Mission statement/statement of social responsibility.</li> </ul>	<ul style="list-style-type: none"> <li>✓ Charitable donations;</li> <li>✓ Employment data;</li> <li>✓ Pension fund adequacy;</li> <li>✓ Consultation with employees;</li> <li>✓ Employee share ownership schemes;</li> <li>✓ Employment of the disabled;</li> <li>✓ Health and safety or environmental remediation.</li> </ul>

Adapted from R. H. Gray, *Trends in Corporate Social and Environmental Accounting* (London: British Institute of Management) 1991b, p. 3.

## The need for standards?

### *Language variations*

There is a growing body of experiences in corporate social and ethical accounting, auditing, and reporting, particularly across Europe and North America.<sup>21</sup> Associated with this development has been the emergence of varied terminology and differing approaches. There are “ethical accounts”, “social audits”, “human accounting”, “intellectual capital”, “ethical audits”, “social performance reports”, “social balances”, “ethical budgets”, and “social reviews”, just to name a few. As with any new or re-emerged field of work, we are faced with a veritable outpouring of new terminology. The question is whether this is helpful. How can we tell when terminological differences are a cover-up for sameness, imprecise thinking, or a deliberate muddying of the waters; or when on the other hand it signifies real diversity, and indeed productive innovation?

In some cases, different words seem to describe methodologies that appear on closer inspection to be very similar. The “ethical audit” advocated by the European Institute for Business Ethics and the Nijenrode Business School,<sup>22</sup> for example, is similar in many respects to the method developed, adopted, and applied by Traidcraft and the New Economics Foundation, which the former calls “social accounts”, and the latter organisation calls “social auditing”.<sup>23</sup> The Body Shop’s “ethical audit” seems, on the other hand, quite different from that the “ethical auditing” of Nijenrode University, since it represents a combination of social, environmental, and animal testing audits.<sup>24</sup> The “ethical audit” of The Body Shop is, on the other hand, only in very particular areas comparable to the “ethical accounting” developed at the Copenhagen Business School and adopted by Sbn Bank and other companies and public sector organisations across Scandinavia.<sup>25</sup>

What some are calling social accounting or auditing is increasingly incorporating financial and environmental data, and is slipping headlong towards what might be called “sustainability auditing”.<sup>26</sup> These dimensions of sustainability in

turn look quite similar in principle to what The Co-operative Bank is calling the “Partnership Approach”. British Telecom variously refers to its commitment as a social or an ethical audit without being entirely clear (at least to others) as to whether they are seen as equivalent. Grand Metropolitan has announced that it is piloting “social audits”, but as yet has not clarified what is and what is not included in their approach. Recently, we have seen the drafting of an audit model by the audit firm, SGS, in collaboration with the U.S. corporate responsibility non-profit organisation, the Council on Economic Priorities (CEP), for dealing only with suppliers that has been called a “social accountability” audit. Then there are approaches that use entirely different language, but in some respects are quite similar to the mainstream of what is emerging, such as the Intellectual Capital model developed at Skandia in Sweden.<sup>27</sup>

Finally, there is intense work going on inside the closed portals of many of the larger “blue-chips”, particularly but not exclusively those subjected to public criticism over recent months and years. Shell International has formed a Social Accountability Group, including senior managers, and are exploring how best to enhance its social reporting. Shell U.K. has already announced that it will publish a “Shell in Society” report during 1998. The Danish pharmaceutical company, Novo Nordisk, has recently embarked on a three year enquiry into what it calls “human and social accounting” with the support of the Danish Ministry of Social Affairs. In many of these cases, the principles of social and ethical accounting, auditing and reportins are being taken on-board in the methods deployed, although the companies are taking great care to avoid the use of such language that still seems to them to be associated with too extensive a public commitment to on-going and verified disclosure.

### *Acceptable variations*

Much of the diversity in practice can be attributed to at least four significant differences in:

- (i) interests on the part of those initiating the process;
- (ii) types of organisations;
- (iii) contexts, and;
- (iv) theoretical and philosophical roots.

Many of these differences are entirely acceptable in that they reflect varied needs for which different methods are required. For example, organisations like Sbn Bank in Denmark and Woyen Molle in Norway start with an emphasis on the evolution of “shared values” through ethical accounting.<sup>28</sup> Not surprisingly, they therefore focus on dialogue with key stakeholders, rather than third party verification. On the other hand, a company with a concern that it meets the challenge of public accountability may well place far greater emphasis on securing adequate comparison with other companies or accepted social norms and benchmarks. For example, the move by companies in the textiles, sportswear, and toys sectors to adopt and comply with labour codes of conduct in their production in, and purchases from, the South, will focus on external verification precisely because the pressure comes from public consumer campaigns.<sup>29</sup>

Similarly, a company principally concerned with public accountability may focus exclusively on the production of a report for external publication, whereas a company with an interest in social and ethical accounting and auditing as a tool to facilitate internal change may have little or no interest in the published document, but may instead focus on the process of accounting, and the reports generated for internal use.

Identifying the “right” approach to social and ethical accounting, auditing, and reporting is therefore intimately related to *why* the particular organisation is engaging in the exercise. This implies that there is no single approach that is correct for all situations: that there is some strength in diversity for diverse needs.

#### *Unacceptable variations*

At the same time, there are variations between methods and practice that are not justified by any objective difference in circumstance and need.

These are variations that are rooted in one or both of two reasons for poor practices:

- ☒ an under-specification of the accounting, auditing, and reporting process because of insufficient knowledge, skills, experience and/or resources applied to the process, and/or;
- ☒ a deliberate attempt to under-specify the accounts and the verification process in order to report in a less-than-accurate, incomplete, or unintelligible, manner.

For example, a company may forgo a dialogue with staff to determine key issues of concern to them because of inadequate resources, and as a result develop a survey that omits a range of critical issues that would profile the company in a negative light. It would not be appropriate, for example, for a “fair trade” organisation (e.g. one seeking to offer a better deal to community suppliers in the South by offering a better deal than in the fully commercial market) to carry out a social and ethical accounting, auditing, and reporting exercise without adequate consultation with Southern suppliers.<sup>30</sup>

Similarly, a company may seek to undertake an externally verified exploration of the social impact of one area of their operations knowing full well that there is a critical problem associated with an area of their work that they have chosen to omit from the assessment. A social and ethical accounting or auditing exercise undertaken by a bank that did not deal with the nature of its investment portfolio, or an exercise by an advertising company that did not consider with care the nature of the images they were promoting and their effect, could not really be seen as being of adequate quality.

The challenge is to be able to distinguish between acceptable and unacceptable reasons for methodological (and terminological) differences. The failure to meet this challenge effectively will allow the “bad to chase out the good” as companies and consultants alike find good reason to cut corners to save costs, and to omit difficult areas from accounting, auditing, and reporting. The ability to distinguish good from bad practice therefore provides a foundation on which standards can be set.

Many things can undermine what we understand as quality in social and ethical accounting, auditing, and reporting. Economic downturn, for example, places pressure on resources, and might also lessen the interest of some key stakeholders in the non-financial dimensions of corporate behaviour. Consumer's interest in "green" products and services declined sharply, for example, after the onset of the economic recession of the late-1980s. Bad practice can also chase out the good. If some companies "get away" with producing superficial or indeed deceptive social and ethical reports and statements, others will tend to turn away from the more costly quality processes. This will be all the more so if bad practice gives the whole field a bad name. It would only take a few demonstrably poor audits and accounting processes that had not been picked up on by external verifiers to undermine the credibility of the process.

It is not adequate for corporate social and ethical accounting, auditing, and reporting to be only a "fair weather" practice. For it to be meaningful, it needs to be a practice in which a company engages as automatically as it would with a financial audit irrespective of their level of profits. Neither is the practice going to give any reliable indication of corporate social performance if a company or their consultants can design the process entirely to their needs and interests, and name it and the results in any way they choose. For it to be meaningful requires that the quality of a company's practice of social and ethical accounting, auditing, and reporting is as clear to all interested parties as is the technical quality of the goods and services they produce.

*The consolidation of the practice of social and ethical accounting, auditing, and reporting in a way that improves corporate social performance requires a mechanism for protecting the practice from such undermining conditions.*

There is therefore a need for agreed standards of corporate social and ethical accounting, auditing, and reporting. Whilst experimentation has and can in some areas continue to yield a wealth of experiences, there is equally a need to limit the danger of a fragmentation of efforts and directions leading to considerable confusion as to what

different methods are being used, and to what effect. As Rob Gray explains:

The long history of social and ethical accounting has been characterised by a *disturbing* variety of approaches and standards. . . .<sup>31</sup>

Although there are clearly dangers in seeking to determine standards for social and ethical accounting, auditing, and reporting, there are also clear potential gains. First, divergent terminology and method can be a sign of flourishing creativity in the early stages of the life-cycle of an innovation of any kind. For the innovation to mature in terms of more widespread use or take-up, however, requires that it becomes less dynamic, more stable, and more recognisable. There is already evidence of resistance to take-up associated with a confusion as to which approach is more effective, or more generally which will "win-out" in the end.

Second, one of the reasons for organisations undertaking some kind of social and ethical accounting and auditing is that it allows them to make claims about their openness, and hopefully about their sound social practice. Such claims can only be made of course where their basis is seen to be legitimate in the eyes of the intended audience. It is interesting to note that there appears to be little or no challenge of those organisations preparing Ethical Accounting Statements, possibly in part because of the more open culture of Scandinavian countries, or the (perhaps associated) lower level of social conflict. In the U.K. and the U.S.A., on the other hand, organisations have invested heavily in securing some form of explicit legitimising process in the form of an external audit or verification.

There is ample evidence that a strong "assurance label" aids take-up where it is underpinned by robust standards that are widely acceptable, such as in the area of financial and environmental auditing, or product labels for organic, safety, or "fair trade" qualities. As the CEO of one major commercial bank stated quite bluntly:

Come back to talk to me about social auditing when you have a quality label that is recognisable in the market that I can put on all of our literature.

Rightly or wrongly, the value of social and ethical accounting and auditing in building an organisation's public profile is an important factor in determining take-up, and an agreed set of standards is an essential element of making this factor count.

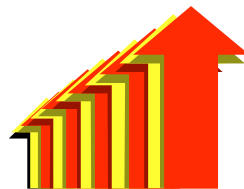
By far the most important reason for standards, however, is *to ensure quality* in the process of accounting, auditing, and reporting to support improved corporate social responsibility. This is not merely a question of what gives a method respectability, or what gives an organisation some market gain from adopting such a method. This is about what methods seem to work best in achieving the underlying aim of assisting organisations in achieving continual improvement against agreed social and ethical aims, and indeed of challenging and raising the aspirations of those aims themselves.

#### *Routes to standards*

Standards can be achieved in a number of different ways. At one extreme is the *benchmark of practice*, where leadership in quality is established that others must follow if they want their attempts to be taken seriously. Leadership benchmarking has a critical role to play in the take-up of any innovation, itself a major reason for adopting the sort of five stage corporate social reporting model outlined above.<sup>32</sup>

#### **the standards spectrum**

- mandatory legislation
- non-mandatory legislation
- private external screening
- voluntary codes
- leadership benchmarking



There are many good examples of leadership benchmarking in this field. Sbn Bank's annual Ethical Accounting Statement has certainly come to be seen as a benchmark against which corporate social reporting in Denmark and elsewhere in Scandinavia is judged. Traidcraft's Social Accounts have set a standard in the British context, as evidenced by the companies that have

sought to draw from and be measured against Traidcraft's standards of quality. The latter case is interesting in the way that it has precipitated an escalation of standards. The Body Shop has drawn from both Traidcraft's and Sbn Bank's example, but has also sought to set new and higher standards. Ben & Jerry's Homemade is a further case in point, having undertaken some kind of social reporting for seven years. As the United States Trust Corporation, a socially responsive investment firm, stated in the August 1995 edition of its newsletter *Values*:

Ben & Jerry's, which publishes unedited conclusions of its independent social auditor, remains the "gold standard" in open, self-critical evaluation. . . .

Skandia, with its focus on "intellectual capital", has established a very different kind of leadership in carving out a very different language and approach that is likely to prove a critical new element in the next round of evolution of social and ethical accounting and auditing more generally. Most recently, the position taken by British Telecom has provided a new form of leadership, if only at this stage by virtue of the fact that BT is the first "blue chip" which has committed itself to following in the emerging tradition of social and ethical accounting, auditing, and reporting. It is clear that now BP and other companies are similarly seeking for ways to take a leadership role in their social accounting, auditing, and reporting.

Leadership benchmarking does, however, have its limitations. A proliferation of different approaches, for example, can undermine the quality push of leadership benchmarking. It is possible, furthermore, for a concerted effort on the part of "followers" which do not wish to follow to marginalise the example set by the leader. Representatives of large, mainstream corporations attending seminars on social and ethical accounting and auditing, for example, have argued that it is only relevant for "weird companies that try to mix ethics with business".

The more radical the innovation in question, the more likely is it that a serious attempt to marginalise it will occur. So leadership benchmarking is important at early stages in the life of

an innovation, but can be of less use at the critical stage where serious mainstream adoption is being sought.

At the other extreme are standards established through the force of legislation. Clearly the advantage of legislation is that the standards cannot be simply ignored. This is most obviously the case with financial accounting and auditing, where extensive legislation exists. Over recent years, this has increasingly been the basis for standards in environmental auditing, although still to a far lesser extent than financial auditing, and with far greater variation between countries. Some countries have legislation covering some aspects of social and ethical accounting and auditing. In the U.K., for example, corporations over a particular size are obliged to report on their charitable giving, as well as having to provide certain information regarding staff conditions and employment practices, such as the proportion of staff who are registered disabled.

There are, however, also disadvantages to relying on the law to secure standards. First and foremost is the sheer time involved in getting to the point of legislation. Clearly a part of this process is very productive, involving an iterative process of distilling the required standards into a form that can be reasonably expected to hold across many different organisations in different situations. Much of the process, however, is decidedly unproductive time spent in endless, bureaucratic, and extremely costly debates. Underlying this is a potentially far more serious objection to seeking legislation to secure standards. This is the danger of down-grading under pressure from strong vested interests. There is little doubt, for example, that any attempt to enshrine key principles of social and ethical accounting and auditing in law would elicit serious objection from many parts of the corporate sector. It is very likely, furthermore, that any legislation that was agreed upon would represent a watered-down compromise compared to the original vision. It is this weak legislation that would then become the basis for standards. The question is then whether weak legislation is better or worse than no legislation.

Between the extremes of leadership bench-

marking and legislation are a range of other means through which standards can be set, including for example voluntary codes and private external screening. Those options that tend towards voluntarism and self-policing have the dangers of becoming confused over time, and also of degrading in the face of pressure from the main body of organisations which do not wish to follow the examples set.

The most productive approach to standards is to see the various options as complementary rather than exclusive. It is necessary to set quality standards through leadership “in practice”. These standards then need to form the basis for negotiation on voluntary codes, and ultimately for legislation of some kind. Leadership standards create pressure for codes and legislation, and can help in resisting any watering down of what those standards might be. Voluntary codes and legislation ultimately help in preventing a gradual erosion of standards through the abuse of method and its use for crude public relations exercises.

The development of standards must therefore be skilfully managed by those wishing them to count. There is no reason to assume *a priori* that formal standards are better than no standards, whether set through voluntary codes, or embedded in legislation. A key determining factor of whether the formalisation of standards helps or hinders in building real quality (and in this case, real accountability) is who is “at the negotiating table”, and their relative strengths. The more open and public the debate, the more likely it is that the watering-down process can be avoided or at least minimised. At the same time, negotiation-by-confrontation is an inadequate route to agreeing standards that need to be both relevant and feasible, particularly in the business context.

### **Developing standards**

There are clear signs of a convergence of standards taking place in the practice of social and ethical accounting, auditing, and reporting. The relevance of both external benchmarks and stakeholder dialogue is confirmed in most current practice, albeit to differing degrees in each case.

Even those approaches which have focused exclusively on one or other element are now moving towards some combination. The originators of the Ethical Accounting Statement, for example, are actively exploring how external benchmarks as well as verification might be used where the approach has to date focused exclusively on stakeholder dialogue. Companies such as British Telecom which are known for their environmental reporting and activities related to the European Total Quality Management, are now actively exploring how best to integrate these experiences with the emerging standards in social and ethical accounting and auditing. Within the public<sup>33</sup> and private, non-profit communities,<sup>34</sup> increasingly attention is also being given to this emerging body of experience.

A similar convergence is taking place in the understanding of the need for and roles of the external agent, although again with different emphases. Ben & Jerry's, for example, has in its recent history of social performance reports seen the external agent essentially as an "evaluator", asked to pass personal judgement on the company's social performance. More recently, however, they have been experimenting with a move away from this personalised judgement process more towards a view of the external agent as "auditor", charged with the duty of ensuring that the published statement is a correct description of what happened over the period, rather than his or her view of those events.

There is a gradual consensus emerging as to what constitutes some of the key principles of "good practice" that need to be reflected in any sound approach. This understanding is focused on three key areas. First, to ensure that social and ethical accounting, auditing, and reporting becomes an increasingly bounded and hence defined set of activities; it needs to become less and less possible for anyone to describe anything as being the practice of social and ethical accounting and auditing. Second, that not only the activity and outcomes, but their quality, become subject to assessment as a part of the "professionalisation" process. Third, there is a need to ensure that what skills and experiences are required to support the process of social and ethical accounting, auditing, and reporting

becomes more and more precisely specified and testable.

This emerging consensus is being driven in the main by the Institute of Social and Ethical AccountAbility, and the individuals and organisations which have come together around AccountAbility's networks of activity. Far from closing the door to further experimentation, this emerging consensus allows for a more systematic assessment of different approaches, a clearer dialogue between them and their users, and a deeper appreciation of what skills and experience are required to make any process effective in achieving the understanding, transparency, and accountability.

#### *Principles of "quality"*

There are therefore good reasons for establishing ways to compare different approaches with a view to judging quality relative to the needs of the particular situation. There is a need, in short, to ask the question, "In short, how can one tell if a specific exercise in social and ethical accounting, auditing, and reporting is worth the candle?"

Below is offered a simple framework for exploring the quality of initiatives in social and ethical accounting, auditing, and reporting. Given the sheer scale of experimentation in this area, and its increasing quality across many different contexts, this framework should be seen as a first stab at what needs to be further developed over the coming period. The framework offers a means of categorising experiences or initiatives by:

- ☑ *principles* of quality social and ethical accounting, auditing, and reporting;
- ☑ the *elements* into which the principles can be sub-divided to enable more detailed analysis through an assessment of the disclosed documentation.

The key objectives against which quality needs to be assessed have been drawn together to take account of a number of factors:

- ✓ the need to secure appropriate levels and

- forms of stakeholders dialogue to ensure good quality information and an “inclusive” approach based on method rather than the discretionary interests of the organisations involved;
- ✓ the interests of key stakeholders in comparing the organisation’s performance over time and with other organisations;
  - ✓ the pragmatic need to establish a method that is technically and financially feasible;
  - ✓ the need to ensure that the method helps the organisation and its stakeholders to learn and change for the better;
  - ✓ the need to secure legitimacy of the overall process.

With these criteria in mind, a grouping of eight “quality principles” have been evolved and tested.<sup>35</sup>

#### *The Eight Principles*

Inclusivity  
Comparability  
Completeness  
Regularity and Evolution  
Embeddedness  
Externally Verified  
Communication  
Continuous Improvement

- 1 *Inclusivity*. The principle of *inclusivity* means that the social and ethical accounting and auditing must reflect the views and accounts of all stakeholders, not only the particular stakeholders who have historically had the most influence over the evolution of the organisation’s formal Mission Statement. What this means, furthermore, is that the assessment cannot be based on a single set of values, or a single set of objectives. Whilst over time the various stakeholder groups *may* come to agree on many things, the assessment process cannot assume this to be the case, and must therefore be able to accommodate such diversity.<sup>36</sup> It is important to distinguish “consultation” in the form of one-way surveying, i.e. essentially market research, and “dialogue”, which can be understood as a two way process that brings the views and interests of all parties to the table.<sup>37</sup>
- 2 *Comparability*. The principle of *comparability* is quite simply that social and ethical accounting, auditing, and reporting enables the performance of the organisation to be compared as a basis of assessment. Comparison may be of the performance of the same organisation in different periods, or with external benchmarks drawn from the experience of other organisations, statutory regulations or non-statutory norms.<sup>38</sup> It is important that external benchmarks are selected for their relevance and legitimacy, not only for their accuracy. For example, comparisons of wage rates with outside organisations need to select the appropriate types of organisations, and also need to draw the comparative data from sources that would be considered to be legitimate (such as government statistics, or labour research bodies).<sup>39</sup>
- 3 *Completeness*. The principle of *completeness* means that no area of the company’s activities can be deliberately and systematically excluded from the assessment. This principle is important to ensure that the company is not “cherry-picking” the areas of its activities that on inspection will show the most positive social and ethical performance. Comprehensiveness in combination with the principle of inclusivity raises major practical problems given the potential magnitude of the assessment process. A typical supermarket chain, for example, may have 10–20 million different individual customers, and 5,000 or so suppliers. What this means in practice is that not everything can be covered at once, or more specifically

during any one cycle. The essence of this principle is therefore that no area of the organisation's activities are necessarily excluded from any particular cycle because of any unwillingness on the part of the organisation, i.e. no "malicious exclusion". Over several cycles, furthermore, all of the principle stakeholder groups would be covered through an exploration of all the effects of all of the organisation's activities.<sup>40</sup>

- 4 *Regularity and Evolutionary.* Not only may it not be possible to cover an entire company's "social footprint" at the same time, but it is likely that this footprint will vary over time. Furthermore, the impact and meaning given to its footprint will also vary, as the composition and expectations of key stakeholder groups change over time. The implication of this is that one-off accounting exercises are not adequate to the needs of either management in seeking to understand what is happening, or in terms of the company's accountability to the wider public. A key principle against which the practice of social and ethical accounting, auditing and reporting needs to be judged is therefore whether the exercise is repeated in a manner that demonstrates "learning" and continual challenge. That is, the process must follow an *evolutionary* path over time.
- 5 *Embeddedness.* As with both financial and environmental auditing, it is not enough for an organisation to get a snapshot of its performance to secure its learning processes in these areas. It is essential for any systematic process that the organisation develops clear policies covering each accounting area. In addition it needs procedures that allow accounting to be regularised and the organisation's awareness and operationalisation of policies and commitments to be assessed through an audit.
- 6 *Communication.* The question of whether the social and ethical accounting and auditing processes are intended primarily for an internal audience, i.e. as a management tool, or whether it is a means of strengthening public accountability, is a tension that has figured in both the reasons *why* compa-

nies engage in the process, and the *means by which* the accounting is undertaken. Clearly the focus on an internal audience obviates any need to disclose the results to the public, or even perhaps within the organisation beyond the management and board. At the same time, an interest in strengthening the company's legitimacy in the public domain would require some sort of disclosure. Where a disclosure route is chosen, the matter of quality concerns then the extent to which disclosure is a formality or an active means of communication with key stakeholders and the wider public. Merely publishing a document – however comprehensive – does not constitute "good practice" if the document is difficult to obtain, costly, or unintelligible to key stakeholders. Disclosure is essentially about communication, which in turn must be rooted in meaningful dialogue for it to be effective.

- 7 *Externally Verified.* The need for external verification concerns again the relative emphasis between social and ethical accounting as a management tool and a means of strengthening accountability and legitimacy. Clearly an emphasis towards the latter implies the need for external verification of some kind. The challenge is, of course, what kind of "external verification" process will be of a sufficiently high professional quality and independence for it to have its desired effect of validating the published material. In broad terms there appear to be three dimensions of external verification that need to be taken into account:
  - the professional competence that we would normally identify with auditors and verifiers;
  - the professional competence associated with management consultants who can understand process, risk assessment, and strategic management;
  - the quality associated with it being awarded a sense of civil legitimacy, which is normally a role taken on by non-commercial organisations with a recognised public interest mandate.

8 *Continuous Improvement*. The aim of any social and ethical accounting, auditing, and reporting system must be to assess and contribute to substantive progress, rather than only deal with retrospective performance, or focus exclusively on process achievements in terms of monitoring, measuring, auditing and reporting. That is, any relevant system must be able to identify whether the organisation's performance has improved over time in relation to the values, missions, and objectives set by the organisation, its stakeholders, and established as broader social norms. Moreover, beyond the measurement of progress is the need for a method that itself supports improvement of social and ethical performance.

These eight principles seem to represent the most basic dimensions of quality against which any social and ethical accounting, auditing, and reporting process can and should be judged. That does not mean to say that a case where several principles are not being adhered to is necessarily "poor" in quality. For example, the Scandinavian applications of "Ethical Accounting" reported on do not include external verification (principle seven), yet this may well be because it is not required given the societal context or the particular applications. So the principles cannot in isolation be a basis for inter-case judgement, although they *can* provide a checklist of things to look for in any assessment or selection process.

#### *Scoring quality*

The eight principles are relevant in offering an initial basis for assessing the quality of any exercise in social and ethical accounting, auditing, and reporting. They are, however, too general to be of use in anything but the most basic assessment process. For example, how can one distinguish between stakeholder "consultation" (essentially limited, one-way) and an approach to stakeholder "dialogue" that it intended to be more deeply participative? When is a questionnaire-based survey acceptable as a form of dialogue, and when is it an imposition,

or simply an inappropriate means of collecting good quality information? There are clearly many possible ways in which "external verification", "comprehensiveness", and "disclosure" can be interpreted. Similarly, there is a need to be able to distinguish between a basic treatment of the environment, such as the application of ISO14000, and more sophisticated "total system" approaches such as the Natural Step.

The approach taken in recent times has been to consider in more depth the possible elements that define the quality of each principle set out above. Specifically, work undertaken by the Institute of Social and Ethical Accountability and the New Economics Foundation has broken down the eight principles into elements against which any particular social and ethical accounting and auditing process can be judged.

The elements and methods for scoring have been based around the view that it must be possible to score the quality of an accounting, auditing, and reporting process based only on the published, i.e. disclosed, information. Drawing inspiration and method from work on environmental reporting undertaken by the United Nations Environment Programme and the environmental consultancy, SustainAbility Ltd., we have therefore constructed a five stage developmental model for social and ethical reporting, as set out pictorially below.<sup>41</sup>

This five stage model clearly does take the step of defining to a large degree what principles and elements are more important than others. Whilst caution is needed in seeking to rank the initiatives of different organisations in often quite different contexts, the model does illustrate how necessary it is for the whole assessment of the quality of social and ethical accounting, auditing, and reporting to develop in the future.

The Institute of Social and Ethical Accountability, in association with the New Economics Foundation, has more recently taken this scoring system one further stage in defining a more specific method for a quantitative scoring of any particular social and ethical accounting, auditing, and reporting exercise. Building on the five-stage model, the approach has involved the development of a comprehensive set of questions that

need to be answered in assessing the accounting, auditing, and reporting process through an examination of the disclosed documents. Scores are associated with the answer to each question, which taken together give an overall score that allows a rating along the five stages. This approach, currently being trialed, will form the basis for an award for the best social and ethical accounting, auditing, and reporting to be launched during 1998 by the Institute.

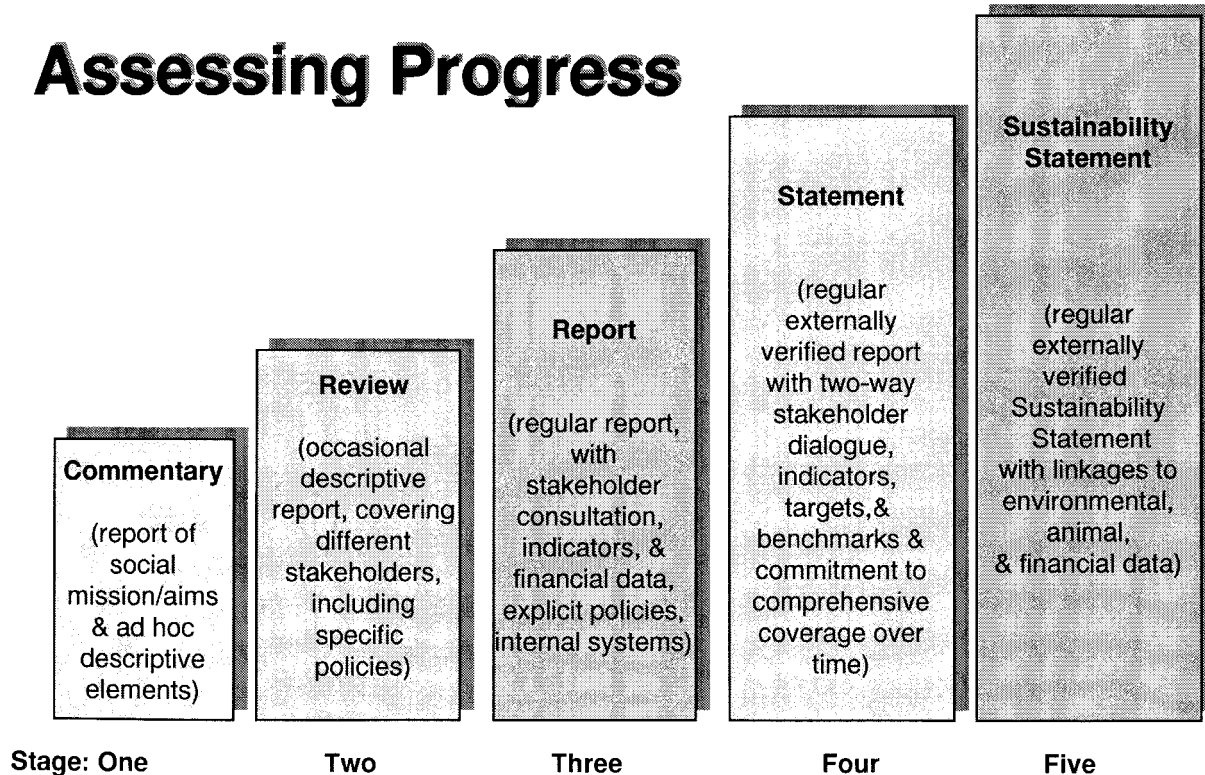
### Accountable futures

There are, and always have been, fine examples of organisations that go beyond the norm in seeking to demonstrate social and environmental responsibility in their practices. These organisations, with their driving mission statements and visionary leaders, show that it is possible to be socially responsible as well as financially viable and indeed profitable. These organisations, particularly those that are commercial businesses, find the spaces in the pipeline between investors and consumers where some choice in behaviour

is possible. Furthermore, they take on the far more ambitious agenda of shifting the basic boundaries by raising public awareness towards social and environmental agendas, and supporting the emergence of new forms of investors that take non-financial criteria into account.

These organisations, be they companies, charities, or non-profit organisations, are the experimental laboratories of the future. Just as Nissan or Ford invest billions in the search for the most marketable car for the millennium, some companies choose to invest in the design of ethical aspects of "tomorrow's company". Social and ethical accounting, auditing, and reporting has been nurtured and developed in these business laboratories in recognition of the need for *conscious, mindful* action to ensure that the corporate sector plays a positive role in securing our future. Measurement is not a passive, neutral activity. If we want social and environmental dimensions of business activity to be taken more seriously in decision-making, we must work out how to count them as one part of a complex and often difficult process of making them count.

## Assessing Progress



## Notes

<sup>1</sup> This paper draws on material from Zadek, S., P. Pruzan and R. Evans: 1997, *Building Corporate AccountAbility: Emerging Practices in Social and Ethical Accounting, Auditing, and Reporting* (Earthscan, London). The author gratefully acknowledges the partnership, inspiration, and efforts of his co-editors in this documentary venture. All views, errors, and omissions are, however, the exclusive responsibility of the author. Comments are welcomed to the author at the New Economics Foundation, 112–116 Whitechapel Road, London E1 1JE, U.K.; Email: [neueconomics@gn.apc.org](mailto:neueconomics@gn.apc.org).

<sup>2</sup> Royal Society for the Encouragement of Arts Manufacture & Commerce: 1996, *Tomorrow's Company: The Role of Business in a Changing World* (RSA, London).

<sup>3</sup> Ibid.

<sup>4</sup> Will Hutton: 1995, *The State We Are In* (Jonathan Cape, London).

<sup>5</sup> van Luijk, H. J. L., S. M. Carmichael, G. J. A. Hummels and A. C. ten Klooster: 1995, *The Technology of Ethical Auditing*, Nijenrode University, The Netherlands Business School, and the European Institute of Business Ethics, Breukelen: 1.

<sup>6</sup> See, for example, a discussion of this in the Royal Society for the Encouragement of Arts Manufacture & Commerce: 1996, *Tomorrow's Company: The Role of Business in a Changing World* (RSA, London).

<sup>7</sup> Anderson, S. and J. Cavanagh: 1996, *Top 200: A Profile of Global Corporate Power* (Institute for Policy Studies, Washington DC).

<sup>8</sup> *Business Week*, April 22, 1996.

<sup>9</sup> A good summary of this argument can be found in Wheeler, D. and M. Sillanpää: 1997, *The Stakeholder Corporation: A Blueprint for Maximising Stakeholder Value* (Pitman, London).

<sup>10</sup> Cooperative Wholesale Society: 1995, *Responsible Retailing* (CWS, Manchester).

<sup>11</sup> Zadek, S., S. Lingah and S. Murphy: 1997, *Consumer Works! Consumption, Civil Action, and Human Development*, paper prepared for the UN Human Development Office.

<sup>12</sup> D. Korten: 1996, *When Corporations Rule the World* (Earthscan, London).

<sup>13</sup> Reported in the Financial Times, Thursday 28th August: 10.

<sup>14</sup> Research was being undertaken at the time of writing this book into which monitoring and verification systems would be relevant and practical in these sorts of contexts. See, for example, Burns, M.,

M. Forstater, D. Osgood and S Zadek: 1996, *Open Trading: Monitoring Corporate Codes of Conduct* (New Economics Foundation and the Catholic Institute of International Relations, London).

<sup>15</sup> Similarly, the *Ethical Trading Initiative* in the U.K. involves a group of major retail companies working together with campaigning and specialist NGOs in formulating supplier-related codes of conduct and suitable approaches to external verification. See *AccountAbility Quarterly*, Issue 4 for a description of this initiative.

<sup>16</sup> Thanks to Professor Rob Gray for this simplified but cogent summary of the origins of financial accounting.

<sup>17</sup> *International Survey of Environmental Reporting: Results Presented at Press Conference September 10th, 1996*, International Institute for Industrial Environmental Economics.

<sup>18</sup> Cairncross, F.: 1996, *Green Inc.: A Guide to Business and the Environment* (Earthscan, London).

<sup>19</sup> R. Hilliary (1996).

<sup>20</sup> See Gray, R.: 1997, 'The Silent Practice of Corporate Social Reporting in Companies: Reconstructing the Silent Account', in Zadek, S., P. Pruzan and R. Evans (eds.): 1997, *Building Corporate AccountAbility: Emerging Practices of Social and Ethical Accounting, Auditing, and Reporting* (Earthscan, London).

<sup>21</sup> Published information on corporate social and ethical accounting and auditing almost exclusively covers Western Europe and the U.S.A. Research has revealed, however, that other experiences exist. One of the most important of these is probably the ground-breaking work of the Indian industrial conglomerate, Tata Industries, which is covered in Gonella, C. and Evans, R. (eds.): 1997, *The Windsor Business Roundtable on Social and Ethical Accounting and Auditing: Summary of Proceedings* (Institute of Social and Ethical AccountAbility, London).

<sup>22</sup> Nijenrode University, The Netherlands Business School/European Institute for Business Ethics: 1995, *The Technology of Ethical Auditing: An Outline* (Nijenrode University, Breukelen).

<sup>23</sup> Zadek, S. and R. Evans: 1993, *Auditing the Market: the Practice of Social Auditing* (Traidcraft/New Economics Foundation, Gateshead).

<sup>24</sup> *The Body Shop Approach to Ethical Auditing*, The Body Shop International, Littlehampton, 1996. See also the entire *Values Report* (1996) which contains all three audits.

<sup>25</sup> Pruzan, P.: 1995, 'The Ethical Accounting Statement', *World Business Academy Perspectives* 9(2), 35–46.

<sup>26</sup> See, for example, Zadek, S.: 1997, 'Sustainability Auditing', in *AccountAbility Quarterly* (Winter), Issue 5.

<sup>27</sup> Edvinsson, L. and M. Malone: 1997, *Intellectual Capital* (Harper Collin, London).

<sup>28</sup> See Pruzan, P.: 1997, *Ethical Dimensions of Banking*, and Lise Nørgaard: 1997, *Ethical Accounting And Dialogue Culture: Worker Rehabilitation In Norway*, in S. Zadek, P. Pruzan, and R. Evans (editors) (1997).

<sup>29</sup> See for example, the paper prepared on this subject by a group of Northern non-governmental organisations, New Economics Foundation and the Catholic Institute for International Relations (1996), London.

<sup>30</sup> See for some discussion of this, Zadek, S. and P. Tiffen: 1996, 'Fair Trade: Business or Campaign', in *Development* (Autumn): 3, 48–53.

<sup>31</sup> *AccountAbility Quarterly*, No. 1 Summer 1996: 5. Italics as emphasis added.

<sup>32</sup> The first volume of the UNEP/SustainAbility report *Engaging Stakeholders* offers a benchmark survey that seeks to set out what the leaders are in environmental reporting, and in this manner to encourage others to follow.

<sup>33</sup> There has been a relatively weak link to date between the quality standards approaches within the public sector and social and ethical accounting, auditing, and reporting. With the commitment of, for example, the Department for International Development of the British Government to explore the possibilities of undertaking a social audit, however, this may change in the future. Also, a significant number of cases of Ethical Accounting in Denmark have been applications within the public sector.

<sup>34</sup> This paper has not really explored the practice of social and ethical accounting, auditing, and reporting in the private, non-profit sector. There is a great deal of work going on in this area, some of which is described in Mayo, E.: 1996, *Social Auditing in the Voluntary Sector* (City University, London).

<sup>35</sup> The first version of these principles were established in 1993 in a paper written by myself and Richard Evans in our preparations for the first social audit of Traidcraft plc. Zadek, S. and R. Evans: 1993, *Auditing the Market: Practical Approaches to Social Auditing* (Traidcraft/New Economics Foundation, Gateshead).

<sup>36</sup> The principle of inclusivity can also be understood as being the equivalent of the standard accounting principle of *materiality*. That is, the rights of stakeholders to choose performance indicators associated with their interests – in conjunction with the right of the organisation to measure its performance also against its own mission statement – is part of what

secures information that is not only accurate but relevant, or "material".

There is an interesting connection with Fourth Generation Evaluation here, which suffers from the methodological defect of requiring balanced power conditions from the outset of the evaluation process. See Zadek, Simon: 1995, *Beyond Fourth Generation Evaluation*, unpublished paper (New Economics Foundation, London).

<sup>37</sup> There have been enormous strides forward in the last decade in developing more participative approaches to dialogue between institutions and their stakeholders. Much of the most interesting work has been in the "development" field, where "participative learning" methods have been developed to cope with gross imbalances of power between the dialoguing partners, such as for example that existing between development agencies and village communities in the South. See, for example, Pretty, Jules, Irene Guijt, John Thompson and Ian Scoones: 1995, *Participatory Learning and Action: A Trainer's Guide* (International Institute for Environment and Development, London).

<sup>38</sup> As for the principle of inclusivity, this principle can be understood in the context of the accounting principle of *materiality*.

<sup>39</sup> There has been intense activity in the area of social indicator development over the last decade, particularly since the Rio Summit under *Local Agenda 21*. A good review of some of this material is provided by MacGillivray, Alex and Simon Zadek: 1995, *Accounting for Change: Indicators for Sustainable Development* (New Economics Foundation, London).

<sup>40</sup> Note too that this may mean that it may be more realistic and relevant for a large, diversified company to develop different social and ethical accounts etc. For different sub-units instead of trying to develop one single accounting, auditing and reporting system for the whole organisation.

<sup>41</sup> See in particular United Nations Environment Programme: 1994, *Company Environmental Reporting: A Measure of the Progress of Business & Industry Towards Sustainable Development*, Technical Report 24, UNEP, Paris, and UNEP/SustainAbility: 1996, *The Benchmark Survey: The Second International Progress Report on Company Environmental Reporting* (UNEP, Paris).

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