

Transparency Management & Corporate Accountability

The Openness Audit (tm) – A Framework for Measuring and Reporting on Transparency and Inclusiveness in Business

“Promoting Financial Integrity”

A Workshop Hosted by
The Institute of Internal Auditors (Santa Fe), and
Association of Gov’t Accountants (San Francisco and Silicon Valley)

San Francisco, CA
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Presented by Mark W. McElroy
Macroinnovation Associates, LLC
Windsor, VT

Goals of Presentation Today

- To introduce attendees to the new field of Transparency Management
- To provide a solid theoretical and practical foundation for Transparency Management that can be used as a basis for measurement and reporting
- To provide practitioners with insight on how to perform transparency and openness audits
- To review key developments in the evolution of Transparency Management
- To inspire and encourage the IA community to embrace Transparency Management, and to at least consider experimenting with or piloting related methodologies

In the wake of the Enron scandal last year,
management guru Warren Bennis of USC said....

“What businesses now need more than ever before are managers
who know how to create *social architectures for openness.*”

NPR, February 22, 2002

Summary

- A presentation about *social architectures for openness*
- In the end, a presentation about the advent of a new branch of management theory and practice – *Transparency Management*
- The implications of Transparency Management on the Internal Audit community
- Three parts:
 - Market Drivers and Indicators
 - Third-Party Scoring and Reporting Schemes
 - Management and Auditing Implications

I. Market Drivers and Indicators

Key Market Drivers

- Post-Enron cries for greater levels of corporate accountability
- Increasing market demand for socially-responsible decision making and reporting
- Increasing market demand for environmentally-responsible decision making and reporting
- Increasing demand for sustainability and other non-financial reporting schemes
- Regulatory factors, such as Sarbanes-Oxley, sunshine laws, etc.

The Effects? Key Market Indicators*

- Half of large multi-nationals surveyed report now taking steps to increase transparency
- Most dissatisfied with own reporting to customers and employees (“most important stakeholders”)
- Shareholders and analysts “get more attention than is warranted”

Transparency Management is increasingly being seen as a proxy for how seriously directors and managers take market demands for greater corporate accountability!

*Source: PwC Survey, 10/02

Key Financial Indicators

- Market tends to reward high transparency levels with share values of between 7% to 25% higher than those of companies with similar financial performance, but whose transparency levels are lower
- A *Transparency Premium* exists that more than pays for related policy and program costs by increasing shareholder value
- Especially where reporting *goes beyond minimum statutory requirements – not just financial information*
- Non-financial reporting critical, too (e.g., social, environmental, and non-financial business processes)

II. Third-Party Scoring and Reporting Schemes

Current Lay of the Land

- No standards exist for transparency measurement and reporting (i.e., reference models or methods)
- Analogous to status of non-financial reporting in other areas, such as Intellectual Capital, Sustainability, and Human Capital
- Some early pioneers can be found, however:
 - Standard & Poor's *Transparency and Disclosure Method*
 - PricewaterhouseCoopers' *Three-Tier Corporate Transparency Model*
 - Sarbanes-Oxley – a pioneering effort of sorts (de jure model)
 - School of Public Policy, University College London
 - Macroinnovation Associates' *Framework for Openness*

Standard and Poors

- *Transparency and Disclosure Methodology*
- October, 2002 study of “corporate disclosure patterns” in more than 1500 companies
- Ranks disclosure patterns in 3 categories:
 - Ownership structure and investor rights
 - Financial transparency and information disclosure
 - Board and management structure and process
- Note extent of reporting that goes beyond pure ‘financial’ issues
- External inspection of annual reports and other regulatory filings and a list of 98 information attributes

Standard and Poors (cont.)

- Key findings:
 - US and UK companies demonstrate highest levels of disclosure globally
 - Latin American and emerging Asian markets are lowest
 - In US, disclosure levels via composite reporting (Annual Reports and other) were consistently high, while levels via Annual Reports alone were more varied
 - Levels of disclosure are closely correlated with market risk and valuations

(Continued)

Standard and Poors (cont.)

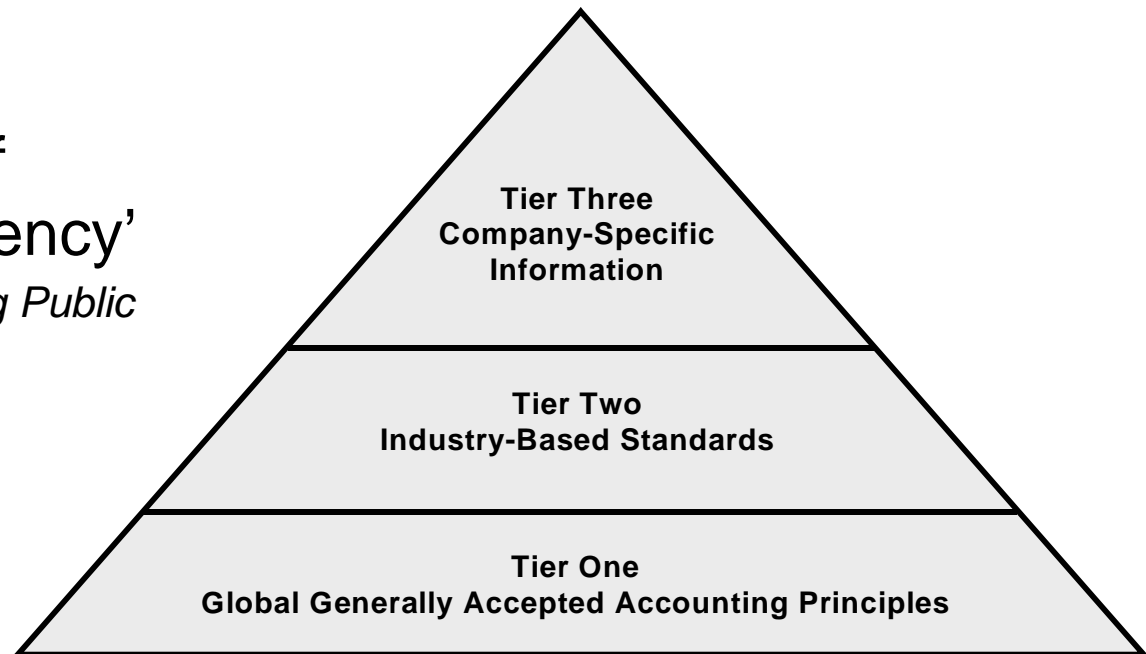
- Key findings (cont.):
 - US Companies with higher transparency and disclosure ratings based on Annual Reports alone tend to have higher price-to-book ratios
 - Companies can lower cost of equity capital by increasing transparency and disclosure
 - Non-financial transparency and disclosure needs improvement

Some Interim Conclusions

- Raising levels of transparency and disclosure in business:
 - Lowers risk (Standard and Poors)
 - Decreases cost of equity capital (Standard and Poors)
 - Increases share prices (shareholder value) (PwC)
 - Increases price-to-book ratios (Standard and Poors)
 - Raises levels of stakeholder satisfaction (common sense)

PwC's Model

- 'Three-Tier Model of Corporate Transparency'
(DiPiazza and Eccles, *Building Public Trust*, 2002)



Specifies transparency in terms of three levels, or domains, of measurement and reporting

Sarbanes-Oxley

- Some say it simply mandates what was otherwise common practice – or *should* have been
- Specifies disclosure duties, mostly financial info:
 - Adjustments identified to a client by its CPA
 - Off-balance sheet transactions
 - High-percentage owners' (10+%) disclosure duties
 - Management assessment of internal controls in periodic reports
 - Code of ethics for senior financial officers (non-financial)
 - Info re: audit committee financial experts
 - Additional info on a real-time basis re: changes in financial conditions or operations (financial and non-financial)

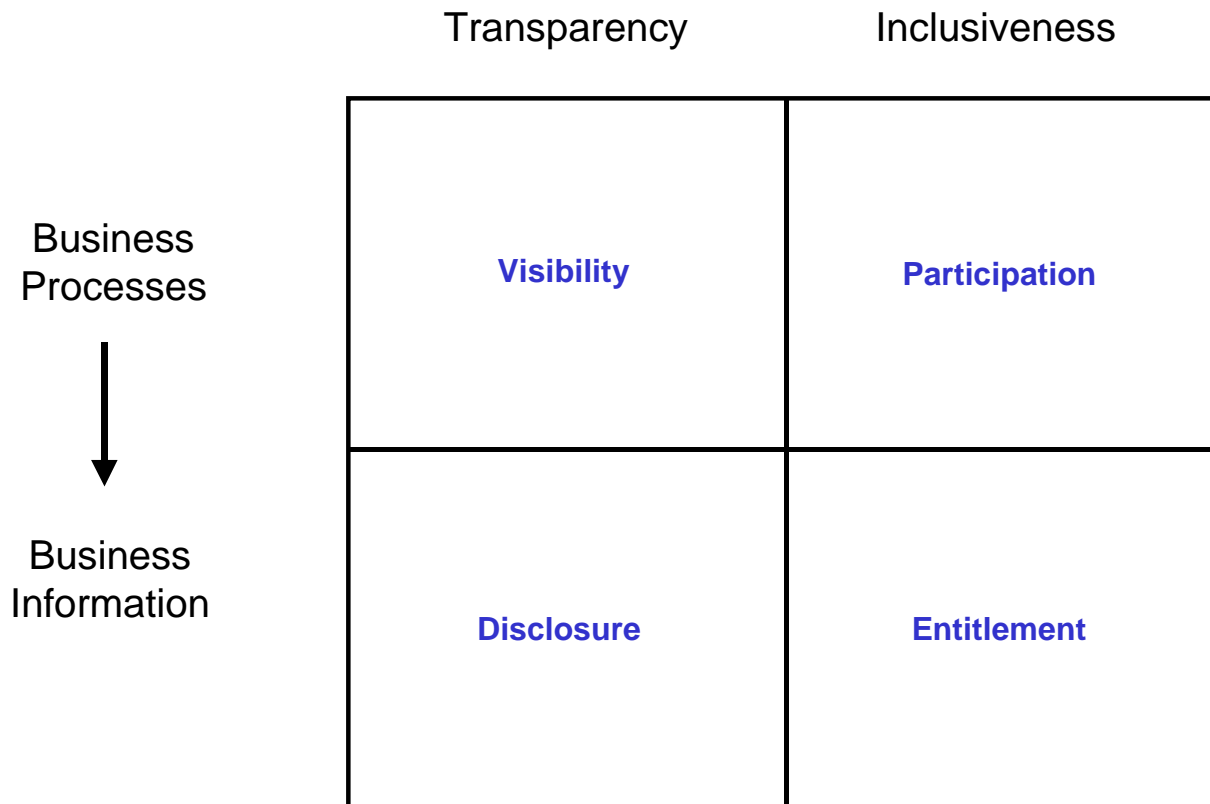
University College London

- Conducted “Audit of Health and Safety Executive’s Openness Procedures and Practices” (12/02)
- Prompted by statutory drivers in UK (Freedom of Information Act which requires greater degrees of disclosure by government agencies)
- Openness “model” defined as:
 - Being honest and frank with stakeholders
 - Making information freely available
 - Being receptive and open to views and needs of others
 - Being open in manner, with a helpful and welcoming stance
 - Also driven by appreciation of stakeholders’ “rights to know”

Macroinnovation Associates

- Openness Audit™ and its Transparency Audit™ component both introduced earlier this year
- Applications of patent-pending ‘Policy Synchronization Method’ developed in 2000
- Defines openness as a measure of 2 things:
 - Transparency
 - Inclusiveness
- Applied to....
 - Business processes
 - Business information

Macroinnovation's *Framework For Openness*



4 dimensions of interest to us – *transparency* only accounts for 2

Comparing the Frameworks

- Using Macroinnovation's *Framework* as a guide:
 - S&P's model focuses only on disclosure of Business Information, mostly financial
 - PwC's model is also disclosure-oriented, albeit with a good blend of financial and non-financial considerations
 - Sarbanes-Oxley is also disclosure-oriented only, with a very narrow focus on certain specific financial and non-financial information items
 - University College London is also disclosure-oriented only, but addresses an even more balanced mix of financial and non-financial information
 - Macroinnovation Associate's model is the only one that takes transparency and inclusiveness *both* into account, and which also addresses Business Processes, not just Business Info.

III. Management and Auditing Implications

Tools and Methods

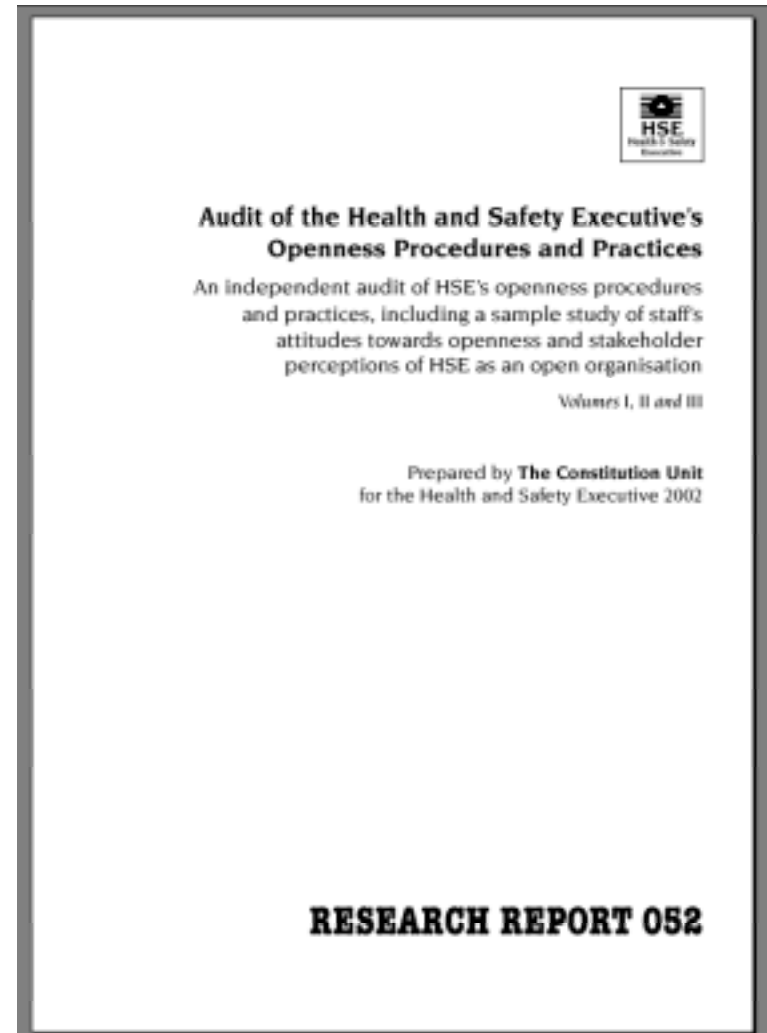
- Only 4 of the 5 early modelers of transparency address internal management and auditing issues:
 - Standard and Poors involves external use by 3rd parties
- Of the 4 remainders:
 - PwC does not specify a method at all (just the *what*, not the *how*)
 - Neither does Sarbanes-Oxley (left up to companies and their audit committees and CPAs)
 - University College London does
 - Macroinnovation Associates does
- Only 2 pioneers out there focusing on systematic approaches to managing transparency and openness

The Two Leading Approaches

- University College London
 - Mostly based on a *Transparency* or disclosure bias
 - *Inclusiveness* in Business Information touched on
 - A true audit.....tied to disclosure rules specified by legislation
- Macroinnovation Associates
 - A more deliberate embrace of both *Transparency* and *Inclusiveness* issues
 - Also covers both dimensions of *Business Processes* and *Business Information* more comprehensively
 - Designed for broad application, not just in response to a particular piece of legislation
 - Meant for use by others, not just its developers

UCL's Efforts, a Notable 'First'

- Perhaps the first openness audit, per se, ever performed
- Completed in December, 2002
- Driven by new Freedom of Information Act in UK
- Very heavy on the disclosure side of the issue (i.e, transparency of outcomes)
- Very light on the process side of the issue (i.e., inclusiveness in management's pre-decision processes)
- Content readily available on-line



UCL's Methodology

- Occurs in 3 stages:
 - **Stage 1** - Fact based: objective is to “identify and assess suitability and effectiveness of [organization’s] existing administrative procedures and practices which inform and instruct [organization’s] approach to openness.” [As is]
 - **Stage 2** - Assessment of organization’s “staff attitudes towards openness and extent to which those attitudes influence the way openness procedures and practices are followed.” [Do attitudes measure up to legal duties?]
 - **Stage 3** - Has objective of testing the organization’s “position on openness against the views of a sample of stakeholders, and making recommendations on how to overcome any shortfalls” identified. [Gap analysis]

Macroinnovation's *Openness Audit*TM

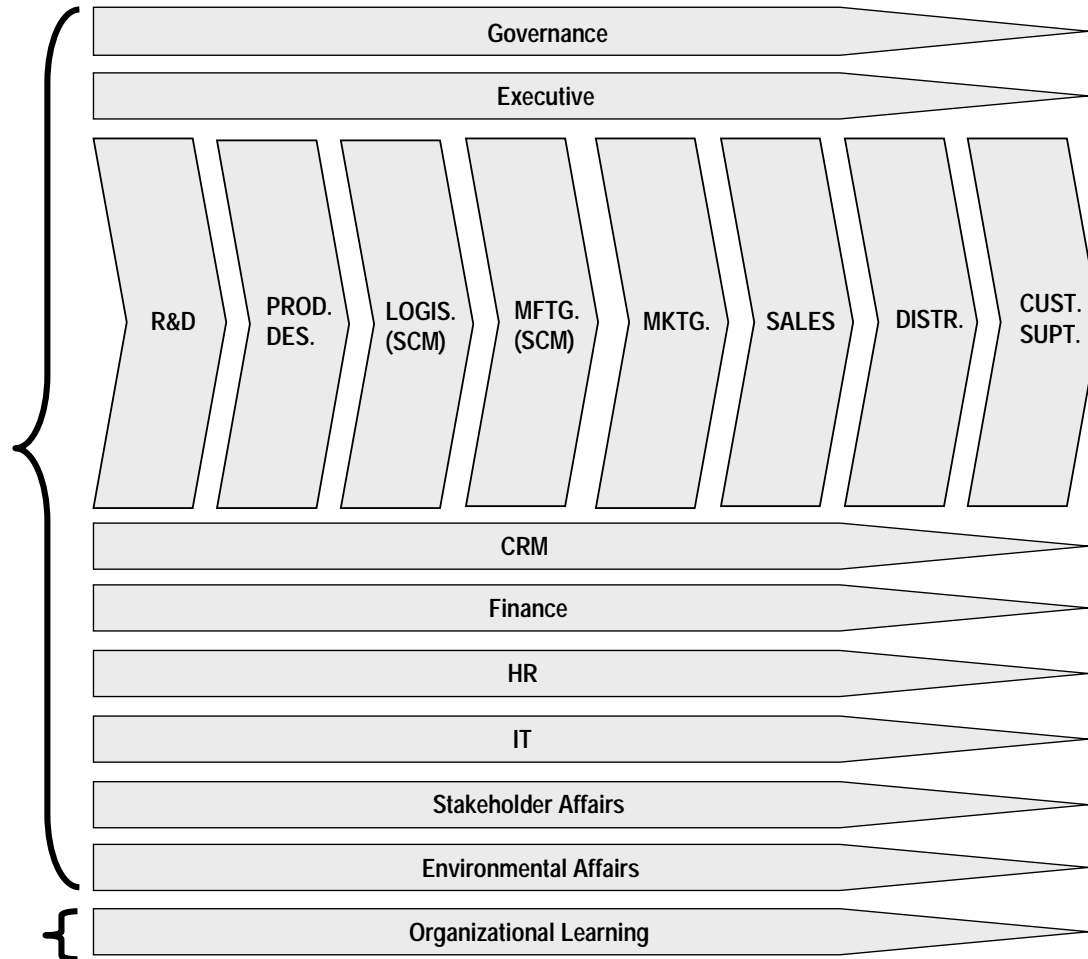
- First, let's define some terms:
 - **Transparency** - The extent to which business processes and related information resources, assets, and outcomes are visible and open to inspection by stakeholders
 - **Inclusiveness** - The extent to which business processes and related information resources, assets, and outcomes are open to access and participation by stakeholders and/or shareable in other ways (e.g., in ownership or entitlement)
 - **Business Processes** - Functions carried out by workers in order to transact business or fulfill strategy
 - **Business Information** - Sources or artifacts which contain data, claims, reports, or insights about markets, customers, competitors, assets, liabilities, or organizational standing

*Openness Audit*TM (continued)

- *Stakeholder driven* – seeks to identify and resolve gaps in openness expectations with stakeholders, not just comply with statutes, rules, or regulations
- Sees inclusiveness, not just transparency or disclosure, as important to openness
- Not just concerned with Business Information, takes Business Processes into account, as well
- Works to correlate gaps, or lack of gaps, in openness expectations with actual policies, programs, and practices in use
- Profiles and reports conditions on all of these fronts

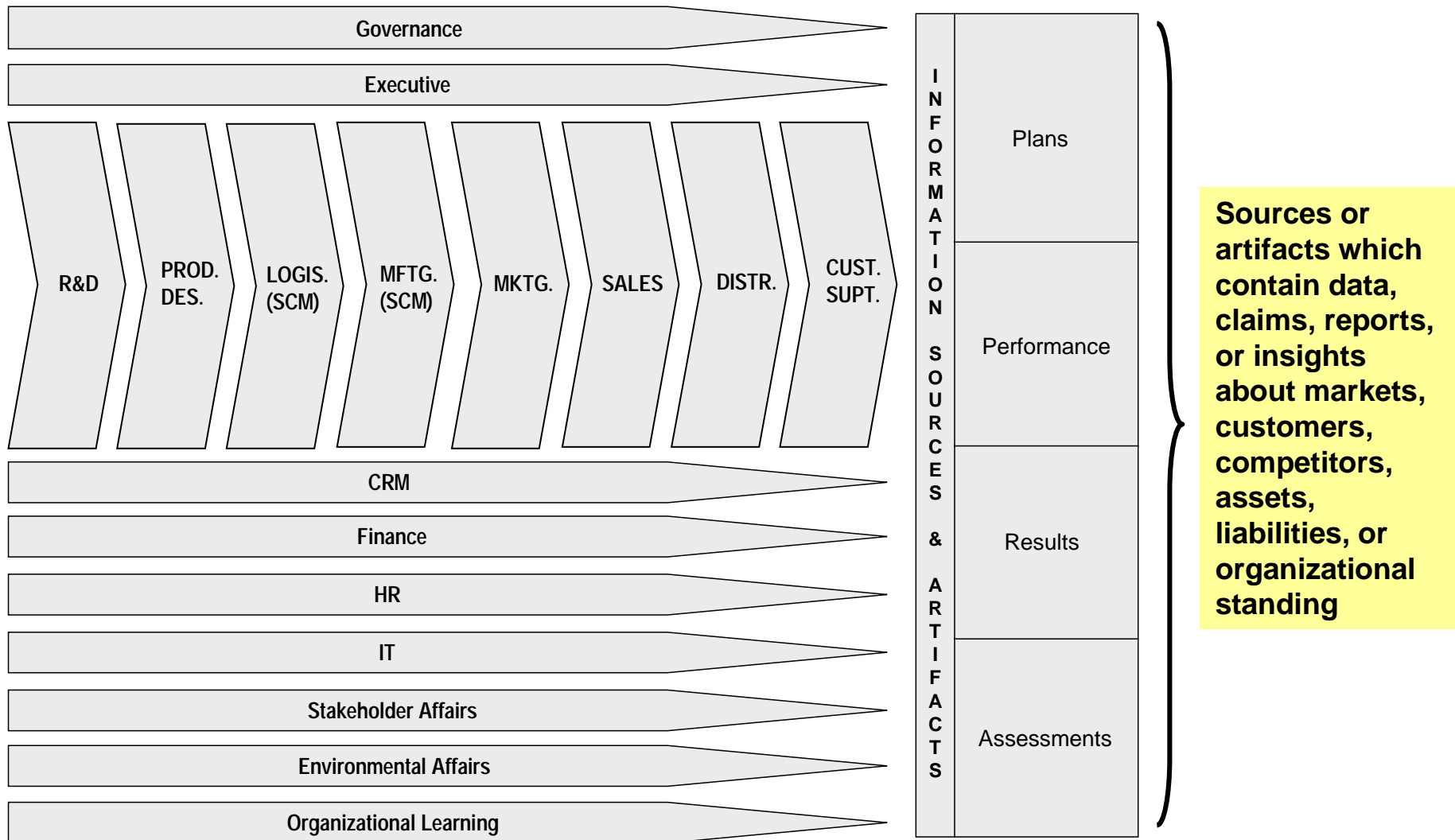
The *Business Process View*

Business Processes
- Financial (F)
- Non-financial (NF)

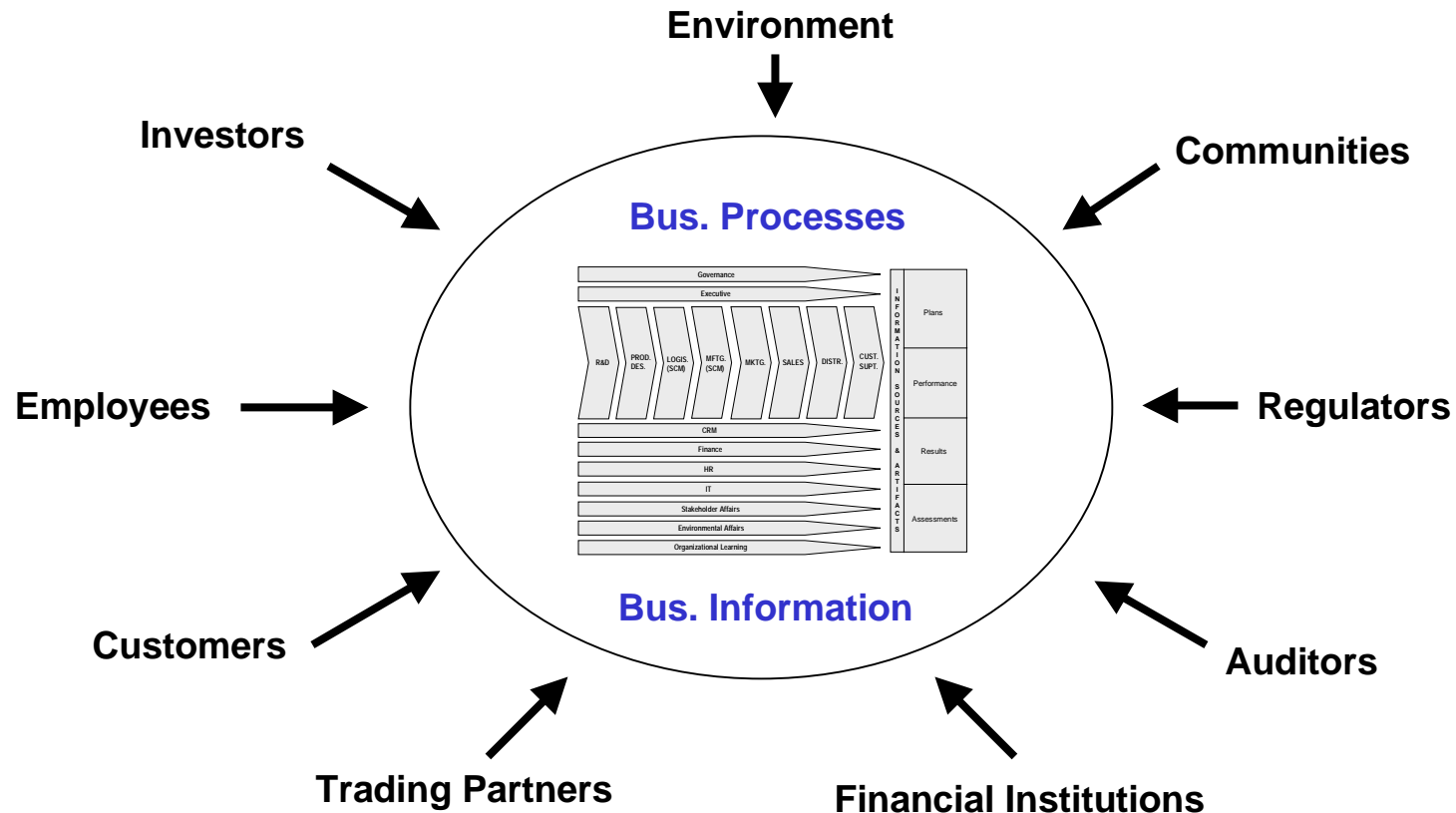


Learning Processes (L)

The *Business Information View*

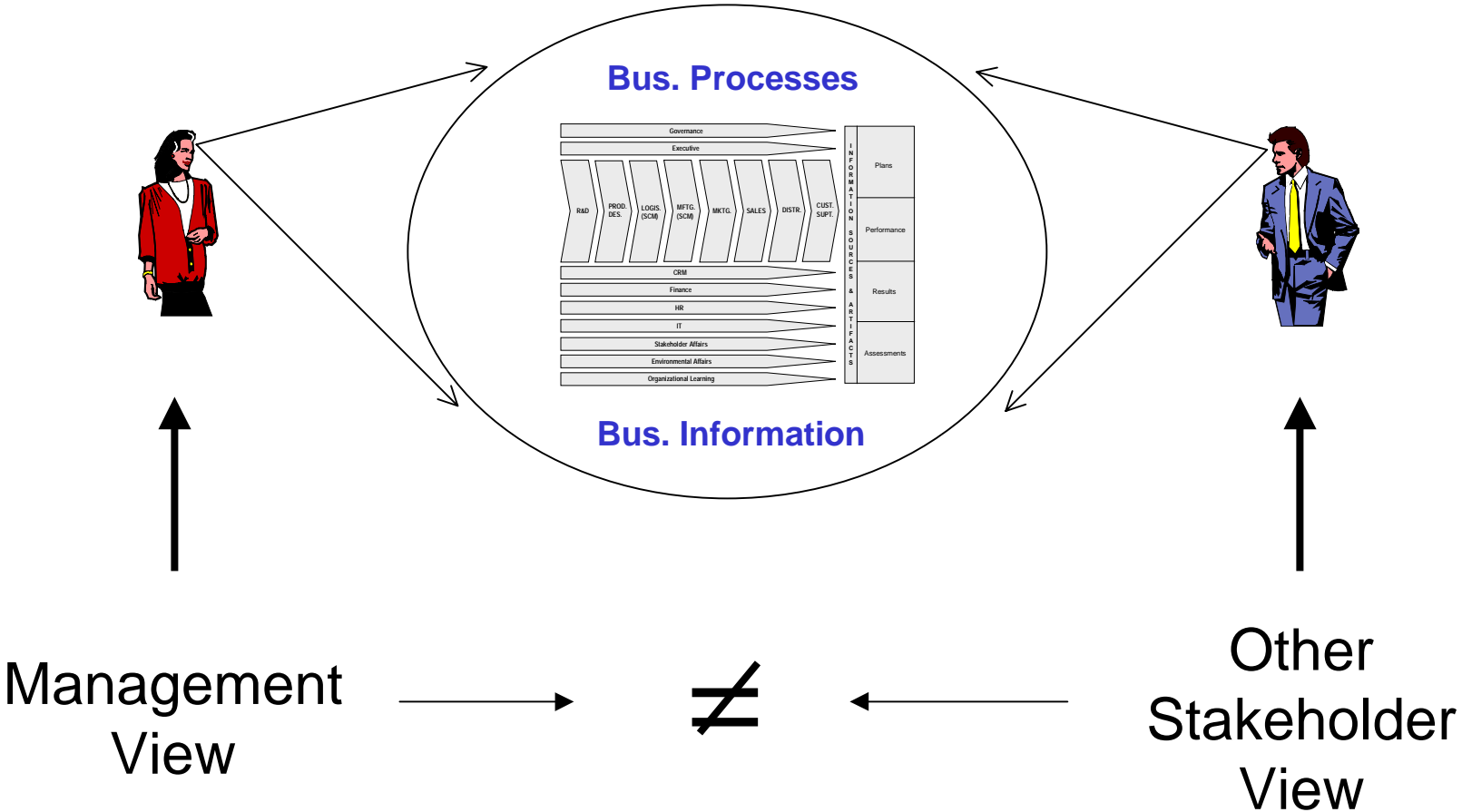


The Stakeholder View

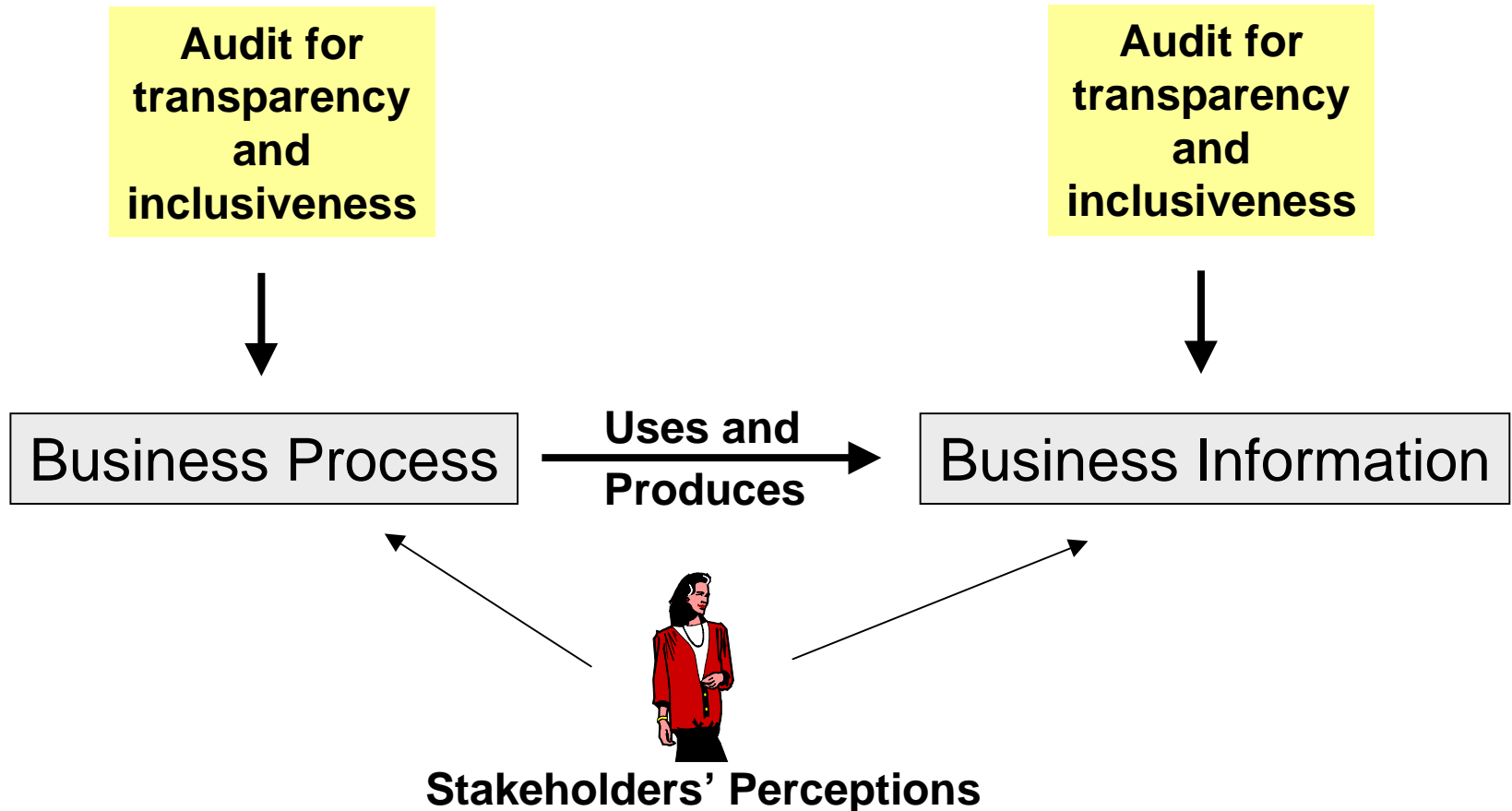


Sometimes gaps in *openness expectations* occur

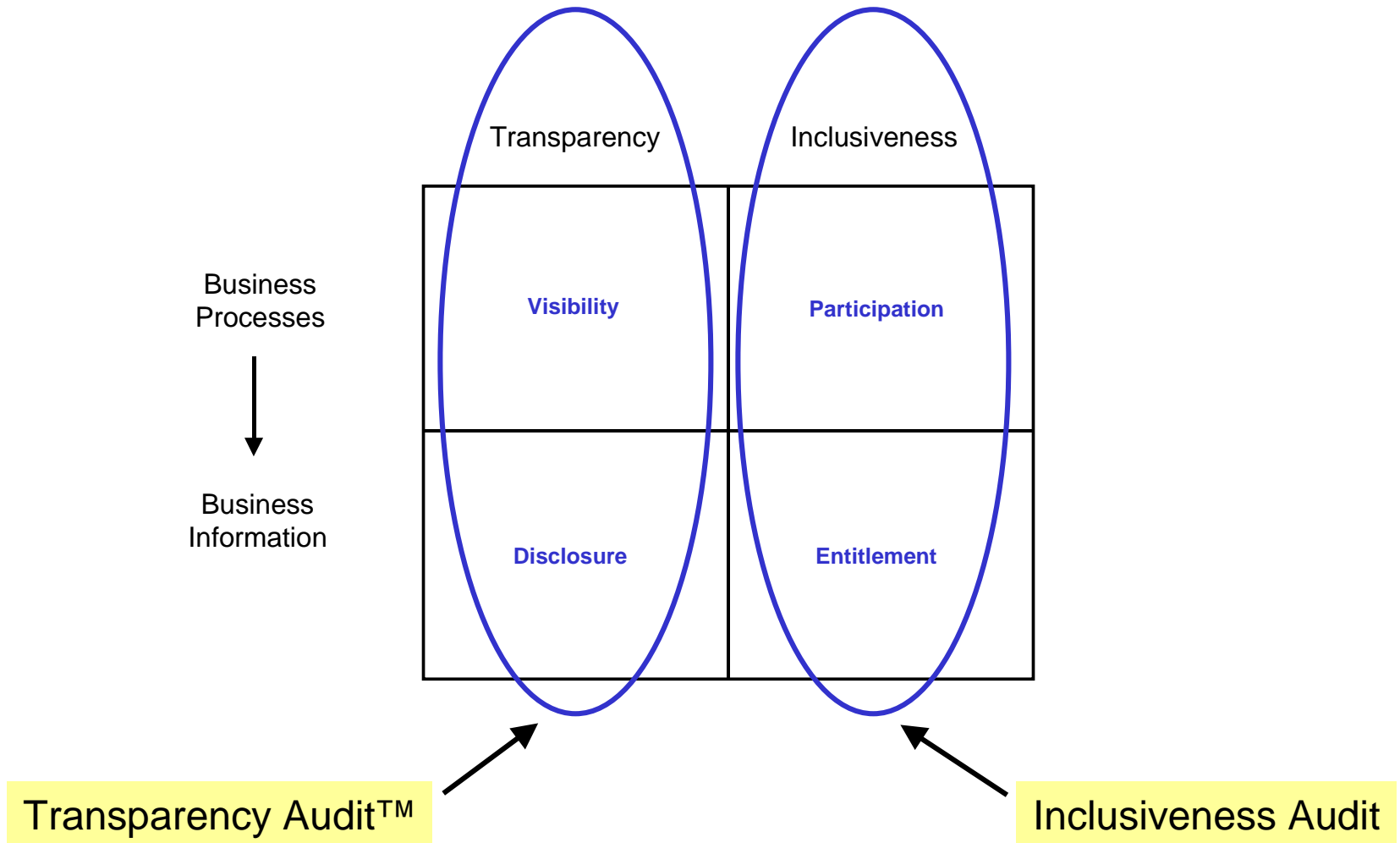
Openness Expectation Gaps



Openness Audit™ in a Nutshell



Openness Audit™: Two Audits in One



Openness Audit™ Scoping Tool

Business Processes & Information Stakeholder Groups	Business Processes			Information Sources and Artifacts			
	F	NF	L	Plans	Perf.	Results	Assmnt.
Investors							
Employees							
Customers							
Trading Partners							
Financial Institutions							
Auditors							
Regulators							
Communities							
Environment							
Other							

Each cell represents a potential target of focus

F = Financial
NF = Non-financial
L = Learning

The Openness Audit™ in Action

Business Processes & Information Stakeholder Groups	Business Processes			Information Sources and Artifacts			
	F	NF	L	Plans	Perf.	Results	Assmnt.
Investors							
Employees							
Customers					PPPP		
Trading Partners							
Financial Institutions							
Auditors							
Regulators							
Communities							
Environment							
Other							

Each cell in the matrix has *transparency* and *inclusiveness* data associated with it:

- Related **policies** in use
- Related **programs** in use
- Related **practices** in use

AND

- Related *management and stakeholder perceptions and expectations*

We can correlate policy, program, and practices with gaps in management and stakeholder perceptions and expectations, if any!

Openness Audit™ Toolkit

- Stakeholder and Management Opinion Surveys
 - Openness in Business Processes (needs, walk, talk)
 - Openness in Business Information (needs, walk, talk)
- Artifactual Data Collection
 - Statutory Environment (Sarbanes-Oxley, etc.)
 - Openness Policies and Programs (incl. web, docs., etc.)
 - Openness Practices (in the record)
- Reports
 - Current Environment (policies, programs, and practices)
 - Gap Analyses (from opinion surveys)
 - Correlation Reports (gaps vs. current environment)
 - Opportunities for improvement

Some Closing Thoughts

Examples of Openness Policies

- An Openness Program in a business might include:
 - Duties of disclosure by management to share decisions, related work products, and reasons for choices made
 - Duties of *non*-disclosure to protect privacy of people in certain stakeholder groups, content of trade secrets, other IP, etc.
 - Duties of organization to comply with disclosure-related statutes, such as FOI laws, ‘sunshine laws,’ etc.
 - Support for enterprise-wide programs that encourage stakeholder scrutiny and discussion of key issues, policies, management decisions, and related corporate actions – resource commitments for this, not just lip service
 - Support for *Free Employee Presses*
 - Support for stakeholder access to management processes
 - Support for self-managed training and learning programs
 - Support for enforcement function (i.e., an ‘openness ombudsman’)

Is Openness the Same as Ethics?

- Many companies have Codes of Ethics
- Issues are related, but not the same
 - Ethics policies deal with propriety and lawfulness of actions taken by employees in the conduct of business (it's about actions)
 - Openness policies deal with transparency and inclusiveness in only those business processes that relate to information and knowledge processing – and also their outcomes (it's about how actions are planned for, selected, revealed, and discussed)
- A firm could be, at once, *ethical and closed*, or *ethical and open*
- Or it could be *unethical and closed*, or *unethical and open* – but not for long, because openness exposes unethical behaviors
- That said, openness is a kind of ethic itself – it expresses a value placed on transparency and inclusiveness in the conduct of business

Thank You!

For More Information
Contact Mark W. McElroy
Macroinnovation Associates, LLC
10 Ogden's Mill Road
Windsor, VT 05089

(802) 436-2250
mmcelroy@vermontel.net