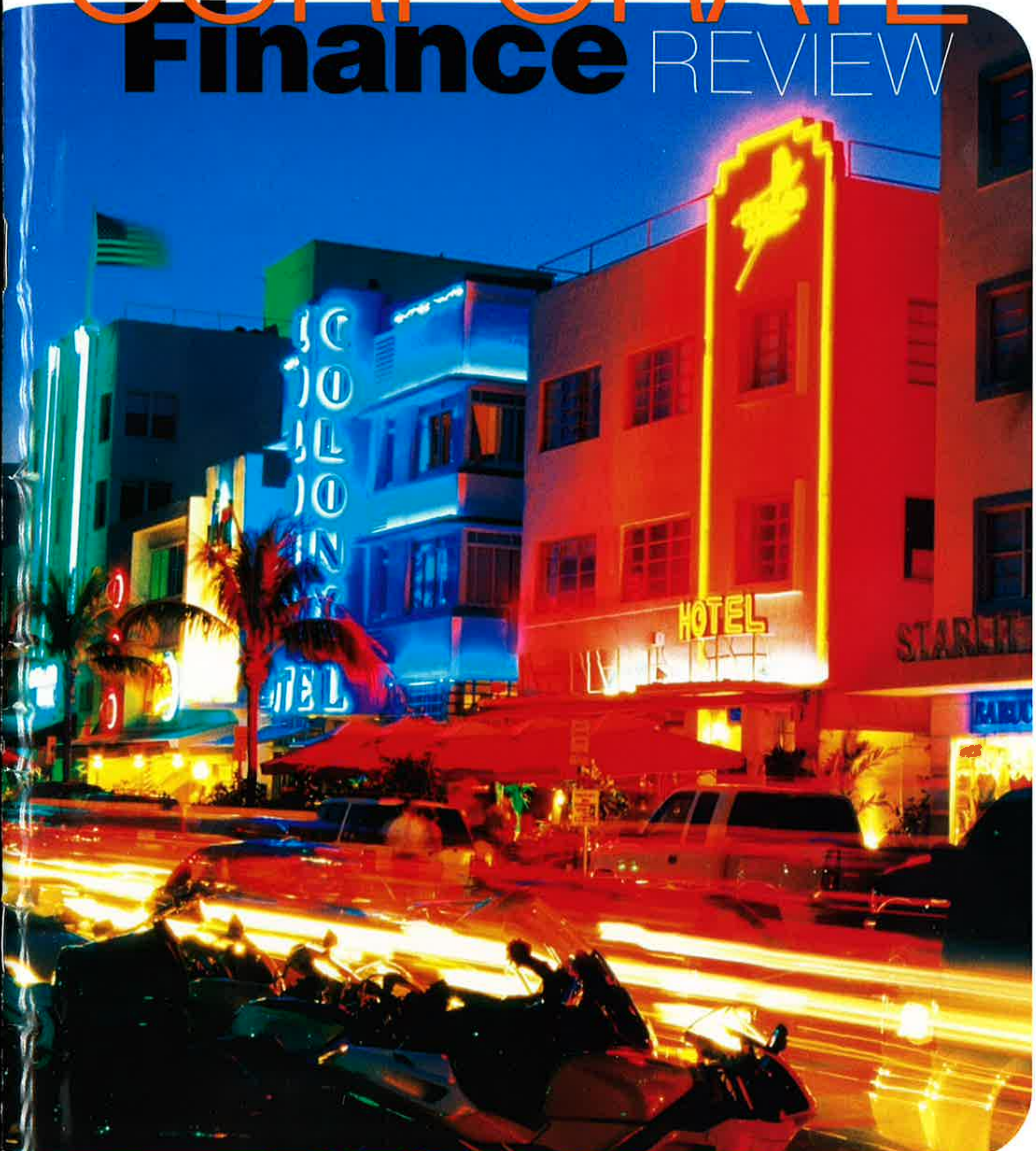
January
February
2012

CORPORATE Finance REVIEW



FATCA—What To Do

MF Global

Valuing Illiquid Assets

Commercial Property Tax Appeals

CORPORATE Finance REVIEW

CORPORATE FINANCE REVIEW (ISSN 1089-327X) is published bimonthly by Warren, Gorham & Lamont, Division of Thomson Reuters, 195 Broadway, New York, NY 10007. Subscriptions: $300.00 a year. For subscription information, call 1 (800) 950-1216; for customer service call 1 (800) 431-9025. Foreign callers (who cannot use our toll-free numbers) should call (914) 749-5000 or fax (914) 749-5300. We encourage readers to offer comments or suggestions to improve the usefulness of future issues. Contact Scott Gates, Editor, Thomson Reuters, 195 Broadway, New York, NY 10007; (212) 337-4129.

Editorial Offices: Thomson Reuters 195 Broadway, New York, NY 10007. All editorial correspondence and manuscripts should be sent to this address. While the utmost care will be given material submitted, we cannot accept responsibility for unsolicited manuscripts. **Web: http://ria.thomson.com/financialreporting/.**

Postmaster: Send address changes to CORPORATE FINANCE REVIEW, Thomson Reuters, 117 East Stevens Avenue, Valhalla, NY 10595.

THOMSON REUTERS

GETTING AHEAD OF LEGISLATED MANDATES: THROUGH VOLUNTARY DISCLOSURE AND REPORTING, CORPORATE MANAGEMENTS HAVE CHOICES TODAY

Almost ten years have passed since the July 2002 passage by the U.S. Congress of the *Sarbanes-Oxley* (SOX) package of federal legislation. SOX focused public attention on corporate governance and addressed, among other things, the need for greater corporate transparency, disclosure, and structured reporting—primarily of financial indicators. Over the next two years, implementation of rules-of-the-road ensued for such things as Title III in the statutes (implemented as rules in Section 303 for senior officer level sign-off of the financial reports). In retrospect, SOX mandates quickly became settled matters.[1]

By late August 2002, the CEOs and CFOs of almost 1,000 large-cap companies were personally "signing off" on the financial reports filed with SEC under both civil and criminal penalties. (All but five company chieftains were able to meet the filing deadlines.) SOX statutes were mostly mandates; little was left up to corporate managers to *voluntarily* adopt or report on.[2] Passage of the 11 titles of SOX laws and the swift adoption of the regulations to implement the statutes for corporate compliance, or ordered mandates for other federal government agencies (including Internal Revenue Service and U.S. Sentencing Commission rule-making), were direct results of the pressures put on members of Congress and the Bush Administration in response to the collapse of Enron in late 2001 and the bankruptcy of WorldCom in spring 2002.

Enron was ranked the seventh largest U.S. company by *Fortune* magazine; what astonished both investors and lawmakers was that the company seemed to collapse overnight. The "books were cooked," media headlines screamed. Soon after, Enron's accounting firm, the global Arthur Andersen organization, imploded. A few months later came the largest U.S. corporate bankruptcy up to that time: the filing by WorldCom/MCI. The early years of the 21st century were marked by a wave of accounting and financial reporting scandals that caught the public's attention: Adelphia, Tyco International, Global Crossing, Quest Communications, and Rite Aid, among others.

The familiar path to reform

It is a familiar path to "governance reform"—first a crisis and financial collapse such as represented by Enron and WorldCom, and then a pell-mell rush to hold congressional committee hearings, form an inquiry commission, and propose a range of bills (legislative measures to address the "problem"). Media coverage expands, and the atmosphere becomes sensationalized; third-party damnation follows ... and finally, laws are passed and regulations promulgated. Throughout the process, lobbyists circle 'round the public discussions, representing the interests of those organizations that will be affected by reform measures.

HANK BOERNER *is Chairman of the Governance & Accountability Institute, the Data Partner for the GRI in the USA, United Kingdom and Republic of Iteland. He is author of* Strategic Governance: Enabling Financial, Environmental, and Social Sustainability. *Email:* hboerner@ga-institute.com.

The most recent examples are the hastened adoption of the Basel III regulatory standards for assuring bank capital adequacy (protecting the banks' capital "cushion" against a repeat of the 2008-2009 financial system meltdown) and the comprehensive *Dodd-Frank* package of legislation (which dwarfs the total text of SOX legislation a decade earlier).

After a wave of mortgage and collateralized debt obligations were widely marketed by U.S. financial firms, especially including below-prime debt, the capital markets in the U.S. entered the crisis mode, to be soon followed by European and other markets. The onset of the *Great Recession* soon followed. And so what were lawmakers to do as the public clamored for action? They did what they were elected to do: enact more laws that required more regulatory measures, and so the massive *Dodd-Frank* package followed—which was far more sweeping in scope than the SOX legislation a decade earlier.

COULD GREATER TRANSPARENCY AND MORE RIGOROUS INTERNAL MANAGEMENT SYSTEMS HAVE AVOIDED SUCH CORPORATE FAILURES AS ENRON?

Could greater transparency and more rigorous internal management systems have avoided such corporate failures as Enron ... or the financial industry meltdown? Of course, we'll never know. But even with SOX-mandated governance reform measures in place, investors saw the values of companies in their portfolios fail or disappear, some overnight; Lehman Bros, Bear Stearns, Fannie Mae, Freddie Mac, and Washington Mutual were among the best known of the enterprises failing as the first decade of the 21st century ended. The decade began and ended with massive investor losses.

But what if companies could be encouraged (by peer pressure, investors, public sector, and stakeholders) to disclose more about the condition of their operations, finances, strategies, and non-financial (or intangible) aspects before a crisis occurs? After passage of SOX, investors and stakeholders—and to their credit, some company managements—coalesced in a few organizational efforts to improve transparency, disclosure, and reporting.

Getting ahead of the issues—voluntarily

The question to be explored: What if corporate managements and boards of directors could put strategies and systems in place to get ahead of certain events that might otherwise ultimately lead to corporate failure? This would likely be followed by public body deliberation and subsequent adoption of *Sarbanes-Oxley* or *Dodd-Frank* type legislative remedies to address real or perceived problems, to exert still more regulatory pressure on managements. (Some legal experts point out that lawmakers always seem to be putting in place measures to avoid the last governance problem—not the one unseen, somewhere over the horizon.) Would voluntary, self-guided measures and reporting work?

Corporate managers and institutional asset managers do have common ground in at least one area of "reform" and precautionary measures: Both often prefer solutions based on self-regulation/industry-regulation, with minimal public sector interference.

More rigorous management systems/ increased voluntary disclosure

In these pages we have previously described the *voluntary* actions of a small but growing number of large-cap corporations in the European Union, United States of America, Asia-Pacific basin, and other world regions in developing and implementing strategies and adopting structured frameworks to ensure greater sustainability and responsibility (S&R) in the enterprise and to provide a generally-accepted means of periodic disclosure and structured reporting on corporate S&R strategies and performance results. Such actions might help to avoid stricter government mandates if effective in addressing risk—and identifying opportunities.

As described previously in these pages, the preferred global framework that has emerged for this voluntary approach over the past decade is the Global Reporting Initiative (GRI), a framework for developing and implementing S&R strategies and actions and then disclosing and reporting on same. The GRI framework provides guidance for reporting on the *boundaries* of the corporate or institutional report, important aspects of *governance,* and, a wide range of key performance *indicators* that the corporate reporter can select from.[3]

As described by GRI, a sustainability report "is an organizational report providing information on economic, environmental, social and governance performance"—all risk management areas of increasing importance to boards and senior managers and to investors in their companies. Using the framework, companies establish a cycle of reporting, from identification of issues to measurement and data collection, to strategy-setting, communication, and voluntary reporting.

The GRI has partnerships with ISO (the global standards setter), the UN Global Compact, OECD, and the UN Environmental Programme. The GRI guidelines are synergistic with the International Finance Corporation, Earth Charter, and the UN Conference on Trade and Development. An increasing number of financial analysts and portfolio managers utilize GRI reporting in their respective analysis, valuation, and investment decision-making.

U.S. voluntary corporate reporting

About 20 percent of the Fortune 500® companies—the largest companies in the USA by measure of revenues, with all but a handful being large-cap publicly-traded enterprises—have to date issued reports that in the main follow the GRI framework. In 2011, it is expected that more than 200 U.S. companies and institutions will issue S&R reports, most following GRI guidelines. (The final tally for the calendar year is usually determined by March of the following year.)

Starting in 2011, the author and colleagues have been systematically collecting, analyzing, and databasing key elements of reports issued in the USA during the calendar year just ended. Among the well-known brand marketers and corporate names that issued reports in 2011 and their sectors were:[4]

- Food & Beverage Manufacturing and Marketing: Clorox, HJ Heinz Company, Brown-Forman, Dean Foods, Sunny Delight Beverages, Yum Brands, Starbucks, Sara Lee, Kellogg, General Mills, Coca Cola Company, Campbell's Soup Company, Proctor & Gamble, and International Flavors & Fragrances;
- Mass Market Retailing: McDonald's, Dunkin Brands, Wal-Mart Stores, Kroger, Best Buy, and Kohl's;
- Specialty Retailing: Tiffany;
- Healthcare Industry/Pharmaceuticals: Abbott Laboratories, Amgen, Merck U.S.A., Baxter International, Becton Dickinson, Biogen, McKesson, Catholic Healthcare West, Varian Medical Services, CVS, Caremark, and Medtronic;
- Mining and Extraction: Freeport McMoRan Corporation, Resolution Copper Mining, and The Doe Run Company;
- Chemical Manufacturing: Dupont, Dow Chemical, Sun Chemical, and Eastman Chemical;
- Technology: IBM, Hewlett-Packard, Intel, Lexmark, Symantec, Xerox, AMD, Apple, and Texas Instrument;
- Transportation: UPS, FedEx, and Union Pacific Railroad;
- Financial Services: New York Stock Exchange/Euronext, Bank of America, Citigroup, Fifth Third Bank, InterAmerican Development Bank, Northern Trust, MetLife, Wells Fargo & Co., and The Carlyle Group;
- Industrial Leaders: Cummins, Caterpillar, Northrup-Grumman, Waste Management/WMI, Owens-Corning, and General Electric;
- Energy/Utilities: Duke Energy, Dominion, Entergy, El Paso, Exxon-Mobil, Hess Corp, Marathon Oil, TECO Energy, Sun Power, PSE&G, NV Energy, and Constellation Energy;
- Automotive: *The Big Three–USA:* Chrysler Group, General Motors, and Ford Motor Company (its tenth report);

IN 2011, IT IS EXPECTED THAT MORE THAN 200 U.S. COMPANIES AND INSTITUTIONS WILL ISSUE S&R REPORTS.

- Entertainment: The Walt Disney Company;
- Trade Association: The Consumer Electronics Association;
- Government: USPS (government-owned), U.S. Army, Chicago Department of Aviation, and City of Baltimore, MD;
- Institutions: University of California, Ball State University, Fulbright Academy for Science & Technology, Western Kentucky University, and University of Michigan.

The reports issued in calendar year 2011 will continue to be identified until March 2012.

Global Reporting Initiative: *De Facto* standard

The majority of the U.S. corporate reports follow the GRI G-3 guidelines. All corporate sustainability and responsibility reporting in the U.S. is *voluntary*; what is included in most reports are the mandatory disclosures such as required by the *Clean Air Act* and *Clear Water Act* and other federal environmental mandates. The decade-old GRI framework's purpose is to "enable greater organizational transparency," and it consists of guidelines and recommendations for developing a comprehensive report.

ALL CORPORATE SUSTAINABILITY AND RESPONSIBILITY REPORTING IN THE U.S. IS *VOLUNTARY*.

Organizations decide the extent of reporting following the framework. GRI established "Application Levels" for reports—"C," "B," and "A." These are not grades; the level indicates the extent to which the current GRI guidelines (the G-3.1) have been applied in sustainability and responsibility reporting. Investors and stakeholders know that the Application Level signals the degree of transparency by the reporting organization. All levels are self-declared. There is provision for an independent third party to "assure" all or parts of the report, and on request the GRI will check the report.

Note that U.S. companies and their counterparts in other global markets are not necessarily submitting reports *to* the GRI; often those interested in obtaining corporate reports must search for them in print or digital format, or both. The GRI has established a Data Consortium with independent third parties in a country serving as a Data Partner. GRI does maintain a global database of all reports, and data partners are encouraged to publish a roster of country reports on their own web site. The GRI roster has reports from 1999 through 2011; the final 2011 roster will be available in spring 2012.

What U.S. corporations report on

The range of sustainability, responsibility, corporate citizenship, ethical, environmental, and related reports is as varied as the corporate cultures from which they come. Some are quite comprehensive and reflect the intent of the corporate board and executive team to *voluntarily* disclose and report on issues and concerns of interest to investors and fiduciaries.

An example is the report of H.J. Heinz & Company, a large food products manufacturer and marketer. The company (NYSE:HNZ) released its *Corporate Social Responsibility Report* in November 2011. Management adopted specific global sustainability goals in May 2008, and the 2011 report is an update of progress being made against the goals. CEO William Johnson said (in announcing the report) that the company is on track to achieve or surpass the goals of reducing greenhouse gas emissions (GhGs), solid landfill waste, energy consumption, and water consumption by at least 20 percent (each) by FY 2015.[5]

One highlight was the description of the partnership with Coca-Cola Company (NYSE:KO) to manufacture fully recyclable ketchup bottles (using KO's PlantBottle™ technology); up to 30 percent of the bottle content comes from natural plant materials, reducing the need for plastic.

Like some other U.S. large-cap food manufacturers and marketers, "sustainable agriculture" is in focus. The "Heinz Global Agricultural Program" includes innovative methods for drip irrigation and other approaches, including teaching farmers to grow tomatoes more efficiently, all described in the report.

Heinz produces its sustainability report every two years since establishing baseline sustainability goals in 2005. The 2011 report follows the GRI framework and is a B+ Level. Heinz also responded to the GRI *Sector Supplement for Food Processing* (self-selecting a B Level for that element of reporting).

Heinz has established "Universal Sustainability Practices," which provide a comprehensive framework for each business unit with guidance and goals covering strategic, operational, collaborative, and governance requirements.

The company conducted a *materiality analysis* of key issues, which included organizing a stakeholder focus group to gather input on concerns, reviewing peer reports, conducting internal surveys, and circulating an investor relations questionnaire to key stockholders. Company managers note that defining the materiality of issues is not necessarily an easy task; there is considerable overlap and interlocking of issues—a "complex system" to consider.

A PACESETTER FOR 2011 IS CLOROX COMPANY, WHICH ISSUED A COMBINED FINANCIAL REPORT AND CR/SUSTAINABILITY REPORT.

Key issues in focus for disclosure include greenhouse gas emissions (down 13 percent), sustainable agriculture, innovation, food safety, packaging, and healthy products.

Along with the online report, there are additional reports from HJ Heinz Company available with easy links to the sustainability reports of 2009 and 2007, the Annual Report, and "Good Agricultural Practices."

In the sustainability report "high priority issues" are identified; the report contains information about the company's 15 top brands, which include (in the U.S.) Heinz brand soups, beans, ketchup, and baby food; Ore-Ida® potatoes; Weight Watchers®; and T.G.I. Fridays® restaurants.

Scorecards (and data measurements) are provided for these key aspects of corporate activity:

- Solid waste reduction
- Waste generation reduction
- Water consumption reduction
- Renewable energy
- Transportation/fossil fuels
- Packaging
- Employee engagement
- Worker safety
- Progress on sustainable ag goals
- Economic factors (sales, net income, ROC, EPS, shareholder return)

The integrated report—Clorox Company

Even as the voluntary reporting by companies steadily increases, there are calls by investor groups and non-governmental organizations (NGOs) for more comprehensive "Integrated Reporting"—the combining of the traditional financial reporting (the "annual report") with comprehensive sustainability and responsibility data sets and narrative. The practice has been slow to catch on in the U.S.

A pacesetter for 2011 is Clorox Company (NYSE:CLX), which issued a *combined* Financial Report and CR/Sustainability Report—a Level B+ report (with GRI Application Level Checked). The company's financial and sustainability information is presented in a comprehensive report, which Clorox management intends to issue annually.[6]

The Clorox Company's well-known products directly touch the consumer, including such brands as Kingsford® charcoal, Pine Sol®, Liquid Plumber®, Clorox® bleach, Glad® bags, Fresh Step® cat litter, SOS® scouring pad, and Brita® water filtration systems. Clorox markets in 100+ countries and operates in two dozen (with 39 plant operations); sourcing is global. A brand leader in its categories, the company enjoys either number one or number two market share in all of its categories.

FY sales were $5.2 billion. The company's financial and environment, social, and governance (ESG) performance were released in one report (an integrated report).

The company notes its cultural foundations are characterized by creativity and innovation, and these elements of the culture are intended to come through in the formatting and narrative of the inte-

RECOMMENDED READING

Background—by the author—and related commentary published in CORPORATE FINANCE REVIEW.

- ***Sustainability and ESG Reporting Frameworks: Issuers Have GAAP and IFRS for Reporting Financials–What About Reporting for Intangibles and Non-Financials?*** **March/April 2011 issue.**
- ***Sustainability Rises to the Top of Corporate Strategy-Setting*** **July/August 2010 issue.**
- ***Environmental, Social and Governance Concerns Converging on the Corporate World*** **July/August 2008 issue.**
- ***Your Company's ESG–Environmental, Social and Governance Factors–Are Mattering More Now to Institutional Investors*** **September/October 2007 Issue.**
- ***The Anti—Sarbanes-Oxley Movement: Have Corporate Governance Reforms Gone Too Far?*** **May/June 2007 issue.**
- ***Popular Movements: A Challenge for Institutions and Managers*** **March/April 2005 issue.**
- ***Government Intervention vs. Self-Regulation for the Financial Markets*** **September/October 2002 issue.**
- ***Have We Entered the Enron-Gate Era of Corporate Governance and Accountability?*** **May/June 2002 issue.**

grated report. Clorox is recognized as a corporate sustainability leader—for example, it is one of only 11 companies in the Carbon Disclosure Performance Leadership Index. Its CEO was named "CEO of the Year" by *CR* magazine. The headquarters building is designated Platinum LEED® (for existing buildings)—one of 71 such buildings in the U.S. The report is GRI Checked, contains a comprehensive Content Index, and is printed on post-consumer recycled fiber.

The report is titled, "Think Outside of the Bottle," describing the company's continued sustainable growth, and is presented in ways to be of interest to stockholders and stakeholders. The report is organized around five key areas where managers say the company's business and social imperatives intersect:

- Performance—Financial success with transparency, strong governance, and corporate responsibility embedded in operations;
- Products—Deliver responsible products, made responsibly;
- People—Promote diversity, inclusion, and respectful treatment for everyone who touches the business;
- Planets—Shrink environmental footprint while growing the business; and
- Purpose—Safeguard well-being every day.

The report contains traditional financial performance measures from the fiscal year—July 1, 2010 to June 30, 2011—including an earnings report, shareholder equity recap ($2.7 billion total return over five years), balance sheet, auditor's report, and so on. The report also contains a narrative and a scorecard for each of these, as well as extensive data for environmental performance for the FY. Greenhouse Gas Emissions (GhGs) were independently verified by the *Cameron Cole* organization (enabling the + on the B Application Level report). Environmental goals and detailed metrics include reduction of (1) water use, (2) energy use, (3) waste-to-landfill, and (4) GhG emissions.

The report contains illustrated scorecards for earnings, diversity, product(s) growth, sustainable goals, and other certain metrics (such as reduction of GhG, use of energy, and data on waste water). The concept, staff says, is to report what the company is doing and accomplishing in its corporate responsibility efforts and to clearly communicate strategy, objectives, goals, milestones, and progress. The report contains a Content Index for the GRI G-3.1 Framework and traditional financial tables. Online, the company makes additional background and content available for readers.

Clorox formalized its corporate responsibility strategy about two years ago and now convenes an annual internal summit to report on progress to a senior executive steering committee that includes the CEO. The company has a CR core team that helps drive the strategy and a dedicated Eco-Office team that works on sustainability initiatives.

The 2011 Clorox reports could serve as an excellent example for large-cap companies—or for any size company—of combining required financial performance reporting with voluntary sustainability/corporate responsibility commitments and performance and clearly explaining the strategic foundations of both financial and non-financial (or ESG) performance.

Summing up

U.S. companies have looked beyond the mandates of *Sarbanes-Oxley* to adopt strategies to address what some investors consider to be non-financial or intangible reporting. A growing number of large-cap company managements are embracing the Global Reporting framework and reporting on their strategies, third-party engagements, environmental performance, how they address societal issues, and the organizations and governance of their sustainability and responsibility initiatives. Progress reports are then prepared following the framework of the GRI, which helps to organize and structure the S&R strategies and initiatives. All of this is voluntary—although the European Union is considering making this mandatory for EU companies in spring 2012. ■

NOTES

[1] Explanation of Sarbanes-Oxley legislation: H. Boerner, *Sarbanes-Oxley Law Creating a Challenging Operating Environment for Corporate Finance Professionals*—Corporate Finance Review; March/April 2003—7, No. 5.

[2] *Ibid.*

[3] The Global Reporting Initiative is an independent organization (organized as a foundation) based in The Netherlands with "focal point" offices in New York City, Australia, Brazil, China, and India. Information at: *www.globalreporting.org*.

[4] The USA 2011 Roster of Corporate Sustainability & Responsibility Reports: *www.ga-institute.com/sustainabilityhq/*.

[5] H.J. Heinz (NYSE: HNZ) report is at: *http://www.heinz.com/sustainability.aspx*.

[6] Clorox Company (NYSE: CLX) report is at: *http://2011annualreport.thecloroxcompany.com/Clorox_Annual_Report.pdf*.