

Does Sustainability Reporting have Sustenance? A Marketing Ploy or Management Tool

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Abstract

Sustainability efforts encompass economic, social and environmental management. After decades of promoting such causes, sustainability finally has moved up to the boardroom agenda per PricewaterhouseCooper 2012 report. As companies incorporate sustainability into business strategy, it is crucial for accountants and financial managers to capture the financial implications of those sustainable practices. This case provides an in-depth review of current reporting and measurement of sustainable practices and outlines properties of a sustainable model. Students will analyze reasons for corporations to provide sustainability reports and examine limitations of current sustainability reporting practices. Students are advised to consider what enhancement in current reporting could increase the economic value of reporting efforts and evaluate the relative contribution of sustainable practices that improve firm performance. This case illustrates development of corporate sustainability reporting, the importance of collecting relevant data, analyzing operational data, reporting in accounting and financial terms, incorporating sustainability when making strategic business decisions.

Keywords: Sustainability, Accounting, Balanced Scorecard, G3 Reporting Guidelines, Extensible Business Reporting Language (Xbrl), Strategy, Governance, Financial

JEL classifications: M41, M14, Q56, G39, L19

1. What is Sustainability?

Sustainability involves three basic aspects: economic, social and environmental. Sustainability management refers to the practices that encompass those aspects into the decision making process so as to maintain productivity, diversity, ecological balance and inter-generational equity over time.

2. Sustainability as a Corporate Strategy

Sustainability consciousness is increasing due to increased regulations, supply chain fluctuations, and erosion of brand loyalty. "As the sustainability moves up the boardroom agenda it is increasingly being integrated into corporate level strategic planning." (PwC 2012) When surveyed by PriceWaterhouseCooper over 40% of US CEOs said their investment priorities include improving living and working conditions where they operate and 64% said their investment priorities include maintaining employee health. "We think of sustainability as a key business strategy at Owens Corning", stated Michael Thaman, Chairman of the Board and CEO of Owens Corning. In the financial investment industry, Roger W. Ferguson Jr., President and CEO of TIAA-CREF said, "We believe good governance and socially responsible practices can contribute to better financial performance and expose companies to lower risk." (PwC 2012) The sustainability efforts should proactively start with the investment in improvement of the operational process itself instead of being consequences-driven. Thus investment decisions are the key drivers of the sustainability efforts.

3. Corporate Sustainability Reports (CSRs)

Companies may voluntarily disclose sustainability efforts to investors. Corporate Sustainability Reports (CSRs) generally reports how a company's ecological, financial and social positions are impacted by its manufacturing or operational processes. These reports are often referred to as triple bottom-line reports.

There is no regulatory requirement for sustainability reporting in the US. Many companies do provide CSRs even though publically traded companies are not required to do so. There are many frameworks/formats for CSRs but there is no absolute standard for CSRs. The lack of requirements and formats in reporting results in inconsistent dissemination of information. Some companies provide minimal information while others provide extensive disclosures about sustainability activities within the company. Such reporting is competing with other revenue generating activities for the limited resources that companies have. The management of the companies that provide extensive reporting must feel that it is an efficient use of their resources.

While the emphasis is on external reporting, there are numerous internal applications of these CSRs. They can be useful for monitoring a company's advancements in its efforts and progress toward sustainability goals and objectives. "...sustainability reporting can enhance managers' awareness of emerging business risks (e.g., reputational risk) and opportunities (e.g., tax credits for investing in "green" technologies). That increased awareness can, in turn, lead to improvements in risk management, cost management, and return on investment." (Pounder 2011). For the governance areas, CSR deals with equal opportunities, board structure, compensation packages and oversight of strategic implementation of initiatives related to the economic, social and ecological principles. Thus CSRs are instrumental in the areas of risk management, transparency, and governance.

4. Tools to Measure and Report Sustainability

4.1. Balanced Scorecard

A popular tool used to measure sustainability is the “Balanced Scorecard” (BSC). The traditional balanced scorecard approach gives measurement of perspectives from financial, customer, processes and learning view points, which impact the operational processes. It allows for the qualitative reporting of the firms commitment and progress in those factors. However, except in the financial perspective, it lacks the capability of transforming the qualitative reporting to quantitative analysis of cost savings, liability avoidance, organizational congruence and return on investment. It is suggested by Butler et al. (2011) that this tool can be modified to better align with the sustainable components when sustainability, stakeholders, processes, and learning are integrated into the traditional BSC. This integration then becomes embedded in the day-to-day operations that are in turn linked to the firm’s financial performance.

4.2. G3 Reporting Guidelines

To enhance comparability, transparency and measurability the Global Reporting Organization developed the G3 reporting guidelines which provide a frame work for reporting sustainability. The GRI framework (G3) is the most common framework /format used and is the most comprehensive framework incorporating economic, social and environmental areas of impact.

G3 provides sustainability performance indicators categorized into economic, environmental and social areas. The economic category includes direct and indirect economic value implied, generated, distributed and received from governments. It includes policies and procedures in the hiring and spending on locally-based operations. The environmental category covers materials, energy, water, biodiversity, emissions, effluents, waste, products, services, compliance, and transport. The social category is further divided into human rights, labor, oversight board composition, society and product responsibility subcategories ranging from product compliance and labeling, diversity training and practices, community involvement, to procurement and investment practices in developing countries (Global Reporting Organization, 2012).

G3 Guidelines match activities to company goals and is widely regarded as the defacto standard of corporate sustainability reporting. The comprehensive framework prompting a detailed level of information sharing that allows operational managers to access and contribute at their specific sectors. Nevertheless, it creates a volume of information that makes it difficult for upper level managers to process raw data and extract key implications.

5. Enhancement to Current Reporting

5.1. Integrative Reporting

To de-clutter the traditional sustainability reporting, Integrative reporting was developed in response to managers experiencing information overload. Integrative reporting focuses on material information and presents it in a clear understandable, precise and concise manner to enhance ease of communicating it to stakeholders. It highlights the interdependence of key factors that lead to success with short, medium, and long term considerations. It provides connectivity of financial, governance and sustainability initiatives and performance. Integrated reporting also helps to build trust, increase transparency of organizational capitals and promote integrated thinking, monitoring, managing and communicating the value creation process.

5.2. eXtensible Business Reporting Language (XBRL)

This communication can further be enhanced by leveraging technology to facilitate access to key information. XBRL is a computer language that allows interactive data reporting and analysis for business and financial reporting. Interactive data allows automatic extraction and exchange of data. The Security Exchange Commission (SEC) is already requesting financial reports to be XBRL tagging per the Interactive Data Reporting Standards required by the SEC. The standardized filers provided by the XBRL systems enable consistency among business unit reporting. This will make consolidation of data much more reliable and efficient. Interactive data also improves data analysis and comparison because it can retrieve specific information and allow inter and intra firm comparisons.

6. A Sustainable Model

All in all, no matter what measure or reporting format we use, a sustainable model should have a long term focus. It should take into account current business model and organizational structure when capturing opportunities and managing risk. A governance and remuneration system consistent with the strategic objectives has to be in place to realize the desired results of creating and increasing sustainable value of the company.

The goal of sustainable reporting is multi-fold. Not only do we showcase the progress that the companies have achieved in the sustainable way, it also helps to identify new areas where improvement will be beneficial. As a result, efforts will be directed to the focused areas aligning sustainable practices with the corporate objectives.

Comprehensive reporting of sustainable activities enables extensive analysis but information overload renders the results less than useful. Integrative reporting with interactive data capability will streamline data into an easily retrievable and analyzable format that can be used to enhance corporate decision making. The key of the collection of data and reporting those data is to improve the bottom line.

Currently, the majority of the quantified sustainable reports are non-financial and qualitative in nature. Some attempts have been made to quantify relative progress in the social aspects of sustainability. For instance, in 2011, United Parcel Service (i.e. UPS) has reported 91% full time employee retention rate in their sustainability report. It indicated that it exceeded the 85% target ("Logistics at the Core: Workplace UPS Corporate Sustainability Report 2011"). However, such reporting can be more useful to the managers or investors if it also calculates the extent of the financial improvement on the bottom line. Although it is hard to measure the financial benefits of a work force with higher moral, we can document the cost avoidance that we would experience by having a lower employee turnover. The costs of turnovers include cost of training new employees, loss of efficiency until new employees are trained and time devoted to the hiring process. All those costs can become cost savings when employee turnovers are kept at the optimal level. In order to enable managers to evaluate the financial impact of sustainable efforts, it is crucial to quantify the sustainable efforts in financial terms similar to those in financial accounting annual reports. Financial managers should leverage life cycle accounting data and environmental accounting data provided from accountants and take into consideration of costs and liability avoidance, energy efficiency and appropriate discount rate when making capital budgeting decisions.

7. The Sustainability Report for UPS

Nikki, a new analyst at PWA Investments rushed into the office, carrying a file. “Julia, we need to hurry up! Mr. Jones told me to work on this file. It is on UPS”. Senior Analyst Julia tried to calm her down “We can handle it. Don’t worry. What are all of these folders?”

“These are the sustainability reports for UPS. I have never examined any sustainability report before” Nikki replied. “We need to look at them and then report back to the boss. UPS has this glossy report on its website, but Ms. Jones wants to know if these are genuine efforts that would add value to the company or is it just a marketing thing? He also wants to know how UPS is doing in these sustainability-related issues”

Julia replied, “I don’t have much experience either. This sustainability thing is kind of new in the investment world. Let’s look at their website.”

Julia says “Hah. I have found lots of information on their website. The UPS website is really (<http://sustainability.ups.com/sustainability-reporting>) detailed. The website says that UPS has started evaluating its own sustainability efforts in 2003 and has posted its annual sustainability reports online. The most recent report, which is the report for year 2013, highlights all the aspects of the company’s efforts in sustainability area (<http://sustainability.ups.com/sustainability-reporting>). UPS first lists 13 material issues where it has significant sustainability impact, as well as 4 global trends influencing its business and sustainability strategy.”

Julia continues “Here is a list of the material items related to sustainability.” On the webpage, the company listed the material items as shown below:

UPS Material Issues

- Energy, Emissions, and Fuel Supply
- Customer Privacy
- Labor Relations
- Management of 3rd Party Representatives
- Employee Health, Safety, and Wellness
- Workforce Diversity
- Ethical Conduct
- Digital and Physical Asset Security
- Transparency and Reporting
- Recruitment, Training, and Development
- Sustainable Shipping and Supply Chain Offering
- Network Efficiency
- Disaster Preparedness and Response

Global Trends Influencing our Sustainability Strategy

- Emerging Markets
- Trade Barriers
- Urban Growth
- Social Infrastructure

Nikki adds “UPS states its reasoning behind these reports on their website. The company states that more of their business customers are seeking sustainability information and demonstration of performance. More investors are incorporating sustainability into their financial models. More governments are raising the bar for both disclosure and action on

environmental and social issues. And more nongovernmental organizations and nonprofits are collaborating with them in novel, constructive ways. They add that their primary vehicle to achieve success in this area is through the publication of a comprehensive, independently assured annual sustainability report. I guess they consider all of their stakeholders in this process.”

Julia says “The company has prepared a materiality matrix that shows whether each issue has a high/medium/low impact on business success and a high/medium/low impact on its stakeholders. Then, in the matrix, they mapped each issue within a general high, medium, or low impact issue area. Here is this matrix.” In the matrix that they found on the company website, the sustainability-related issues were ranked according to their overall impact as shown below:

The issues that have a high impact are:

- Disaster preparedness and response
- Labor relations
- Customer privacy
- Energy emissions and fuel supply
- Employee health, safety and wellness
- Digital and physical asset security
- Management of third party representatives
- Workforce diversity
- Transparency and reporting
- Trade barriers
- Social infrastructure
- Ethical conduct
- Emerging markets
- Urban growth
- Recruitment, training, and development
- Sustainable shipping and supply chain offerings
- Network efficiency

The issues that have a medium impact are:

- Child labor, forced and compulsory labor, migrant labor and human trafficking
- Supplier engagement
- Package contents responsibility
- Safe driving
- Environmental compliance
- Living wages
- Greenhouse gas policy
- Fleet noise
- Supplier diversity
- Responsible marketing
- Executive compensation
- Sustainable procurement
- Terrorism and political unrest
- Public policy

- Sustainable packaging
- Health access
- Fuel continuity and prices
- Employee engagement

The issues that have a low impact are:

- Toxic substances management
- Philanthropy and volunteering
- Water use and impact
- Waste management
- Rail/Waterborne freight environmental impact
- Green facilities design

Julia says “Let’s look at this report in more detail. We need to look at the quality of the report. Is this a comprehensive report that covers the firm’s all efforts? Is it a genuine report that reflects the company’s efforts in all sustainability related issues or is it just a marketing ploy?”

Nikki adds “I guess we also need to evaluate their Materiality Matrix. Do we agree with their assessment on impacts or not? As an investment company, we are more interested in the short and medium term results. Therefore, if we want to invest in this firm, we want to evaluate its priorities.”

“Then let’s start working on this!” Julia exclaims. Nikki adds “In our report to boss, in order to give more information about sustainability reporting, we can first make an introduction by answering the following questions:

1. What is sustainability? Give examples of some sustainable practices.
2. Why would a corporation incorporate sustainability into their corporate strategy?
3. What are the regulatory and economic considerations of sustainable reporting?
4. What are the purposes of reporting guidelines?
5. What are the benefits and limitations of current corporate sustainability reports?
6. What enhancements should be made to improve current reporting practices?
7. What are the characteristics of a sustainable reporting model?
8. What are the role of accountants and financial managers on sustainability efforts?
9. What are the impact of sustainable practices on accounting reporting, corporate governance, human resources and ecological management and firm performance?

“I agree” Julia responds. “That would be a perfect introduction section for our report.”

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