

Sustainability reporting: A work in progress

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ABSTRACT

In the aftermath of hurricane Sandy considerable attention will be given to the concept of sustainability. Sustainability should be viewed as a system where the elements of economic, environment and social are highly interrelated. The rebuilding, as a consequence of Sandy, will offer a chance to observe how the three elements interact. The “Sandy” discourse should rejuvenate a concerted effort to reflect on the current state of sustainability and hopefully provide real world, viable solutions based on treating the three elements as a highly interactive system. These solutions should include not only the implementation of more effective efforts but also on the measurement and reporting of those efforts. This paper examines the current practices of reporting and measurement of sustainability efforts. The measurement and communication of those efforts are critical for continued improvement. Currently, the Global Reporting Initiative (GRI) has become the de facto leader in establishing standards for reporting sustainability.

GRI provides a set of performance indicators with guidelines for measurement. Under GRI guidelines organizations are given considerable latitude regarding which indicators to measure and even under which level they wish to report. GRI also provides little guidance regarding third party assurance of sustainability reports. This paper examines the issues and obstacles that, until resolved, will prevent sustainability reports from being credible, comparable and universally accepted.

Keywords: sustainability, reporting, indicators, assurance, economic

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INTRODUCTION

A global awareness of sustainability began in the 1970s with the Stockholm Conference. Prior to this there was little concerted effort to promote or report on sustainability. There were efforts at national levels. For example, in 1969, the United States Congress passed the National Environmental Policy Act, and in 1970, under President Nixon's presidency, the Environmental Protection Agency (EPA) was created. Of the early global attempts, the Rio Conference provided the most important foundation (Agenda 2) leading to the current state of reporting. This paper reviews the progress toward a universally accepted program of sustainability reporting. There are three categories or elements to sustainability reporting, economic, environmental and social. This paper limits its analysis to the economic element. It begins with a historical review, then discusses the current state of reporting and concludes with the salient issues and challenges that must be addressed to achieve a goal of credible standardized sustainability reporting.

THE STOCKHOLM CONFERENCE

Sustainability began as a global focus with the United Nations Conference on the Human Environment, generally known as the Stockholm Conference, held in Stockholm, Sweden in 1972. Delegates from more than 100 countries attended the Conference resulting in the Declaration on the Human Environment, an Action Plan for the Human Environment, and a Resolution on Institutional and Financial Arrangements. Table 1 presents the 26 principles agreed upon concerning the environment and development.

The Stockholm Conference was the first of its kind. It was the first multinational event to focus on sustainability in its current form. Notably absent is the element of Economics. Although the action plan was never acted upon the importance of the Conference lies in the international community's awareness of issues facing the environment and set the stage for subsequent actions (Cleveland, Kubiszewski, Miller 2012).

THE RIO CONFERENCE

The United Nations Conference on Environment and Development, also known as the Rio Conference, was held in Rio de Janeiro. The Conference was attended by representatives from 178 nations and numerous non-governmental organizations. The purpose was to discuss global environmental issues that would become essential for future policy implementation. The result was an agreement signed by more than 130 nations on the Convention on Climate Change and a Convention on Biodiversity, as well as reaching an agreement on Agenda 21. Agenda 21 is an action plan for developing sustainably through this century. All attendee nations accepted the Rio Declaration, a non-binding statement of broad principles for environmental policy (Cleveland, Kubiszewski, Miller, 2012).

The United Nations, in a declaration made January, 2012, reaffirmed previous commitments (<http://www.unmultimedia.org>). The efforts of the previous two decades, and reaffirmed by the UN set the stage for today's advancements in measuring and reporting on sustainability. Companies are now eager to demonstrate good corporate citizenship. Whether this eagerness stems from perceived financial benefits, pressure from society or an ecological awareness continues to be unclear.

REPORTING INCENTIVES

So why do companies report on sustainability? According to KPMG (2011), companies have found that benefits are achieved by a system of continuous improvement inherent in the reporting process. They also reported that improved financial value due to either increased revenue or decreased cost derived from cost savings and enhanced corporate reputation. Ninety-five percent of the largest 250 companies report on corporate responsibility (CR), an increase of 14% in the past three years. Also, public traded companies are more likely to report on CR. In comparison approximately 2/3 of the companies that do not report on CR are U.S. based. Privately owned and smaller companies are least likely to report on CR possibly due to the reduced scrutiny from regulatory agencies and the cost associated with an improved information system. Not surprisingly larger companies, revenues of over \$50 billion, are more likely to report on CR. This puts pressure on those larger companies not currently reporting due to a perception that they are not as transparent as their counterparts. This perception could be a market differentiator leading to reduce market share.

Ziegler, Schroder and Rennings (2008) conducted a study to determine if sustainability performance of European companies resulted in a positive effect on their stock performance. The study examined the relative sustainability performance of the industry in which the company operates and its sustainability performance within that industry. They found that environmental performance had a positive effect on stock prices but that social performance had a significantly negative influence. In another study by Lourenco, et al. (2011) the authors examined how corporate sustainability Performance (CSP) is reflected in the market value of equity. Using a sample of North American firms it was found the CSP had significant explanatory power for stock prices greater than that for certain accounting measures including earnings and the book value of equity. After further analysis it was found that actually what happened is that investors penalize those firms with low levels of CSP. The two studies while having similar results regarding firm value and CSP report the effect occurs in two very different ways. A third study (Lackman, Ernstberger and Stich (2012) found that similar to previous studies investors consider the reliability of sustainability information in evaluating the market value of a company but that the benefits vary cross-sectionally. Firms that have a higher risk react strongly to an increase in the reliability of sustainability reporting. This may be partially due to the perceived transparency of reporting. A third implication of the study is that an increase in the reliability of sustainability information is greater during times of economic uncertainty which also may be due to a perceived level of transparency.

THE KPMG ANNUAL INTERNATIONAL CORPORATE RESPONSIBILITY SURVEY

KPMG's 2011 International Corporate Responsibility Reporting Survey, reported that the percentage of companies reporting on their CSR initiatives from 2008-2011 increased from; 74% to 83% in the U.S., 62% to 79% in Canada, and from 91% to 100% in the U.K. Similar results were found in other regions of the world.

Those companies that receive top sustainability scores have implemented sophisticated information systems and processes to help ensure reliable data. They are usually rated A+ and seek third party assurance. On the other end of the reporting continuum are companies that are only beginning to accept the idea of sustainability. These companies do not show improvements in their information systems, report using a single media, typically a separate report included in their annual report, and rely on less reliable information. Some industry sectors are leading the pack in CR reporting, including; forestry, pulp and paper, mining, and automotive. Those sectors slow to embrace CR are trade and retail and transport. It may not be coincidental that those industries subject to more intense scrutiny, whether from the government or the public, lead the sectors in reporting.

Many competing standards and standard setting bodies have developed indicators of social performance as well as methodologies for measuring and auditing performance of these indicators. These include, but not all inclusive, the Global Reporting Initiative (GRI), the Dow Jones Index, the SA 8000 from Social Accountability International, and the AA 1000 from AccountAbility, as well as portions of various ISO (International Organization for Standardization) standards. Of these, the GRI index has emerged as the dominant standard.

THE GLOBAL REPORTING INITIATIVE (GRI)

The Global Reporting Initiative (GRI) has become the dominant force for sustainability reporting. It was founded in Boston, in 1997 and was created out of the Coalition for Environmentally Responsible Economies (CERES). Its mission is to provide transparency in reporting and emphasizes a stakeholder approach. The foundation or heart of GRI is a set of reporting guidelines. G3's sustainability Performance Indicators consist of three primary categories or elements, economic, environmental and social. The social category has four sub-categories, labor, human rights, society and product responsibility. There are three generations of guidelines, G1, G2 and the current version G3 and G3.1. After the launch of the G3 guidelines the GRI solidified its position by building strategic alliances major international organizations focusing on sustainability (GRI, globalreporting.org).

GRI's reporting framework consists of reporting guidelines, sector supplements, national annexes and various protocols. The guidelines consist of two parts, Reporting Principles and Guidelines and Standard Disclosures. The Reporting Principles and Guidelines cover materiality, stakeholder inclusiveness, sustainability context and completeness. The Standard Disclosures advocates three types of disclosures, Strategy and Profile, Management Approach and Performance Indicators (GRI, globalreporting.org).

The first step in the GRI reporting process is to determine the report content. Next the reporting entity self-declares with which level to adhere. There are three application levels; A, B and C depending on the extent of indicators reported on. The level is self-declared based on the criteria for each level. Level C requires the least conformity with guidelines, followed by levels B and A.

In addition if the reporting organization has received third party assurance on the report they can add a + sign next to their reporting level. Lastly, upon the release of the entity's report they are requested to notify GRI. Entities then may choose one or all of the following three options: notify GRI of the report then provide a copy, register their report in GRI's database and/or request GRI to verify their declared application level (GRI, globalreporting.org).

ISSUES AND OBSTACLES

Although substantial progress has been made toward a credible set of standards for sustainability reporting there are still many obstacles to overcome before global acceptance. Acceptance will require, a common set of standards, with indicators that can be measured without an excessive investment in a company's information system, and provides reliable information. In addition a set of assurance standards similar to those found in auditing must be developed. Third party assurance must come from recognized, independent and credible parties with quality control standards.

The GRI provides a complete set of performance indicators with guidance on their measurement. Performance indicators that companies must report upon depends on their level of reporting, with C being the least rigorous and A being the most stringent. Table 2 illustrates the indicator reporting requirements based on the company's application level.

The performance indicators, while being the heart of GRI's reporting initiative, also allows for considerable non-standardization in measurement. Those companies choosing to perform level C reporting have to measure and report only on 10 indicators with at least one from each category and have considerable latitude on which indicators to measure. The same can be said for Levels B and A. Currently there are 9 economic indicators, 30 environmental indicators and 15 social indicators, for a total of 54 performance indicators. Comparability among companies is not possible when companies measure and report on different indicators. Organizations will measure those indicators that are most favorable and least costly. A review of the GRI database (particularly those reporting at level C) found a wide variation among performance indicators measured. This appears to be the case even within the same industry. Table 3 illustrates, in an abbreviated form, the first three economic performance indicators with measurement guidelines (GRI, globalreporting.org).

A review of Table 3 demonstrates the complexity of measuring the performance indicators. There are nine economic performance indicators but only the first three are presented in Table 3 for illustrative purposes. Reviewing the indicators and guidelines for measurement illustrates the difficulties in presenting standardized reports. The following list enumerates some of these difficulties:

1. variation in which indicators to measure
2. providing cost information due to unsophisticated information systems

3. allocating cost
4. GAAP vs IFRS reporting
5. updating due to changes or new GAAP or IFRS statements
6. calculating Economic Value Generated and Distributed (EVG&D)
7. measurement at the regional level without specific guidance on the definition of regional
8. reporting formats

The above discussion was limited to economic indicators. Environmental and social indicators are no less vague and difficult to measure. The uncertainties surrounding the indicator measurements exacerbates the difficulties of providing adequate third party assurance.

The assurance process does little to ensure comparability. Approximately 45% of reporting organizations obtain third party assurance (KPMG, kpmg.com). The higher the reporting level the greater the likelihood of obtaining third party assurance. GRI has identified six qualities for external assurance and are presented in Table 4.

The GRI guidelines continue with, “GRI does not assess whether the external assurance for a report meets the key qualities for assurance identified by GRI, and offers no opinion on whether the “+” is justifiable. When issuing a reporter with an A+, B+ or C+ Application Level Check Statement, GRI only confirms that an assurance statement has been published in the reporting” (GRI, globalreporting.org)

Just as there is little standardization in performance indicator measurement there is a plethora of assurance providers and assurance standards. The big four accounting firms predominate third party assurers. This is due to existing relationships as a consequence of auditing financial reports.

CONCLUSION

While sustainability reporting is a noble goal it will not reach maturity, and accompanying credibility, until the uncertainties surrounding measurement, reporting and assurance have been addressed. The tragedy of hurricane Sandy should provide a real-life opportunity to observe and document and communicate how the three elements of economic, environment and social act in concert. The degree of communication flexibility must be reduced to that level similar to those found in auditing standards. Previous empirical research has found some association between reporting on sustainability and company value. This association is likely due to perceived transparency rather than actual reporting on sustainability. These studies also do not address whether there is value to third party assurance. Since the sustainability report is not an integral part of the financial statements, current auditing standards provide that auditors are not responsible for determining if the information is stated properly. Therefore the following key questions should be addressed; does the current state of sustainability report reflect reality, does the cost/benefit analysis support reporting and is their any financial value to third party assurance? Historically, these types of issues are not resolved without government intervention. Is this too high a price to pay?

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APPENDIX

Table 1
Principles of the Stockholm Declaration

1. Human rights must be asserted, apartheid and colonialism condemned.
2. Natural resources must be safeguarded.
3. The Earth's capacity to produce renewable resources must be maintained.
4. Wildlife must be safeguarded.
5. Non-renewable resources must be shared and not exhausted.
6. Pollution must not exceed the environment's capacity to clean itself.
7. Damaging oceanic pollution must be prevented.
8. Development is needed to improve the environment.
9. Developing countries therefore need assistance.
10. Developing countries need reasonable prices for exports to carry out environment management.
11. Environment policy must not hamper development.
12. Developing countries need money to develop environmental safeguards.
13. Integrated development planning is needed.
14. Rational planning should resolve conflicts between environment and development.
15. Human settlements must be planned to eliminate environmental problems.
16. Governments should plan their own appropriate population policies.
17. National institutions must plan development of states' natural resources.
18. Science and technology must be used to improve the environment.
19. Environmental education is essential.
20. Environmental research must be promoted, particularly in developing countries.
21. States may exploit their resources as they wish but must not endanger others.
22. Compensation is due to states thus endangered.
23. Each nation must establish its own standards.
24. There must be cooperation on international issues.
25. International organizations should help to improve the environment.
26. Weapons of mass destruction must be eliminated.

(Source:<http://www.unep.org/Documents.multilingual/Default.asp?DocumentID=97&ArticleID=1503>)

Table 2
Reporting Levels

<p>G3 Performance Indicators & Sector Supplement Performance Indicators</p> <p>OUTPUT</p>	<p>Report on a minimum of 10 Performance Indicators, including at least one from each of: Economic, Social and Environmental.</p>	<p>Report on a minimum of 20 Performance Indicators, at least one from each of Economic, Environmental, Human rights, Labor, Society, Product Responsibility.</p>	<p>Report on each core G3 and Sector Supplement* Indicator with due regard to the Materiality Principle by either: a) reporting on the Indicator or b) explaining the reason for its omission.</p>
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(Source; https://www.globalreporting.org/SiteCollectionDocuments/ALTable_En.pdf)



Table 3
Abbreviated Set of Economic Performance Indicators and Guidance on Measurement

EC1. *Direct economic value generated and distributed, including revenues, operating costs, employee compensation, donations and other community investments, retained earnings, and payments to capital providers and governments*

Data on the creation and distribution of economic value provide a basic indication of how the organization has created wealth for stakeholders. Several components of the Economic Value Generated and Distributed (EVG&D) table also provide an economic profile of the reporting organization, which may be useful for normalizing other performance figures. If presented in country-level detail, EVG&D can provide a useful picture of the direct monetary value added to local economies.

To better assess local economic impacts, EVG&D should be presented separately at country, regional, or market levels, where significant. Reporting organizations should identify and explain their criteria for defining significance.

EC2. *Financial implications and other risks and opportunities for the organization's activities due to climate change.*

2.1 Report whether the organization's senior governance body considered climate change and the risks and opportunities it presents to the organization.

2.2 Report risks and/or opportunities posed by climate change that have potential financial implications for the organization, including:

- a. Risks due to physical changes associated with climate change (e.g., impacts of modified weather patterns and heat-related illness);
- b. Regulatory risks (e.g., the cost of activities and systems to comply with new regulations);
- c. Opportunities to provide new technologies, products, or services to address challenges related to climate change; and
- d. Potential competitive advantages created for the organization by regulatory or other technology changes linked to climate change

Report whether management has quantitatively estimated the financial implications (e.g., cost of insurance and carbon credits) of climate change for the organization. Where possible, quantification would be beneficial. If quantified, disclose financial implications and the tools used to quantify.

Core

EC 3. *Coverage of the organization's defined benefit plan obligations.*

2.1 Identify whether the structure of retirement plans offered to employees are based on:

- Defined benefit plans; or
- Other types of benefits.

2.2 For defined benefit plans, identify whether the employer's obligations to pay pensions under the plan are to be met directly by the organization's general resources or through a fund held and maintained separately from the resources of the organization.

2.3 Where the plan's liabilities are met by the organization's general resources, report the estimated value of those liabilities.

2.4 Where a separate fund exists to pay the plan's pension liabilities, report:

- The extent to which the scheme's liabilities are estimated to be covered by the assets that have been set aside to meet them;

- The basis on which that estimate has been arrived at; and
- When that estimate was made.

2.5 Where a fund set up to pay the plan's pension liabilities is not fully covered, explain the strategy, if any, adopted by the employer to work towards full coverage, and the timescale, if any, by which the employer hopes to achieve full coverage.

2.6 Report the percentage of salary contributed by employee or employer.

2.7 Report the level of participation in retirement plans

(e.g., participation in mandatory or voluntary schemes, regional or country-based schemes, or those with financial impact).

2.8 Different jurisdictions (e.g., countries) have varying interpretations and guidance regarding calculations used to determine plan coverage. Calculate in accordance with the regulations and methods for relevant jurisdictions, and report aggregated totals. Consolidation techniques should be the same as those applied in preparing the financial accounts of the organization. Note that benefit pension plans are part of the International Accounting Standard (IAS) 19, however, IAS 19 covers more issues.

(Source: <https://www.globalreporting.org/resource/library/G3.1-Economic-Indicator-Protocols.pdf>)

Table 4
Six Qualities for External Assurance

1. should be conducted by groups or individuals external to the reporting organization, who are demonstrably competent in the subject matter and assurance practices;
2. should utilize groups or individuals who are not unduly limited by their relationship with the organization or its stakeholders to reach and publish an independent and impartial conclusion on the report;
3. is implemented in a manner that is systematic, documented, evidence-based, and characterized by defined procedures.
4. assesses whether the report provides a reasonable and balanced presentation of performance, taking into consideration the veracity of report data and the overall selection of content;
5. assesses the extent to which the report preparer has applied the GRI Reporting Framework (including the Reporting Principles); and
6. results in an opinion or set of conclusions that is publicly available in written form, and a statement from the assurance provider on their relationship to the report preparer.”

(Source: <https://www.globalreporting.org>)

