Corporate Sustainability

Integrating Performance and Reporting

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WILEY

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Cover image: © grandeduc/iStockphoto

Cover design: John Wiley & Sons, Inc.

Published by John Wiley & Sons, Inc., Hoboken, New Jersey

Published simultaneously in Canada

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Library of Congress Cataloging-in-Publication Data:
Brockett, Anne.
Corporate sustainability : integrating performance and reporting / Anne Brockett, Zabihollah Rezaee.
p. cm. — (The Wiley corporate F&A series)
Includes bibliographical references and index.
ISBN 978-1-118-12236-5 (cloth); ISBN 978-1-118-22471-7 (ebk);
ISBN 978-1-118-23806-6 (ebk); ISBN 978-1-118-26279-5 (ebk)
1. Sustainable development reporting. 2. Sustainable development—Economic aspects. 3. Sustainable development—Accounting. I. Rezaee, Zabihollah, 1953- II. Title.
HD60.3.B76 2013
658.15'12—dc23 2012022658

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

This book is dedicated to Mrs. Brockett's family, Mike, Zachary, Noah, and Jacob and the loving memory of Dr. Rezaee's parents, Fazlollah and Fatemeh Rezaee.

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Preface

CORPORATE FAILURE IS TYPICALLY a reflection of ineffective corporate governance and the lack of focus on sustainability performance. Events significant enough to bring down high-profile companies (AIG, Bear Stern, Societe Generale, and Olympus) do not happen overnight and often relate to lack of sustainability performance. In a message to shareholders in the 2012 Annual meeting, the president and CEO of Starbucks underscores the importance of business sustainability in creating value for all stakeholders including shareholders, customers, and communities. This book presents recent developments in sustainability performance and sustainability reporting and assurance. Business organizations are key contributors to sustainability performance to ensure long-term sustainable development of the economy and society. In this context, sustainability reporting and the assurance process in collecting, analyzing, and disclosing sustainability performance is important. The concept of business sustainability and corporate accountability has become an overriding factor in successful strategic planning for many organizations worldwide. Business sustainability is a process of increasing the positive impacts and reducing negative effects of operations on sustainable economic, social and environmental performance. The idea is that an organization must extend its focus beyond making profit by considering the impact of its operation on the community, society, and the environment. The concept of the "triple bottom line" is often used to assess an organization's success from three perspectives—profit, people, and the planet. This expansion of determining an organization's sustainable performance and long-term value-adding strategies has driven a need for new reporting and accountability structures which extend beyond financial statements into nonfinancial key performance indicators based on environmental impact and social responsibility.

This book provides an introduction to the importance, relevance, and benefits of business sustainability and accountability reporting in all areas of economic, governance, social, ethical, and environmental performance (EGSEE). The book identifies financial and nonfinancial key performance indicators (KPIs) for each of the five areas of EGSEE and their integration into the organization's strategic mission, goals, operations, and culture. Traditionally, business enterprises have focused on earnings as the "bottom line" and the major financial KPIs for measuring sustainable performance. As businesses evolved and their role in society as a good citizen was developed and their impacts and possible external costs became more noticeable, the refocus on a multiple-bottom-line was inevitable. The "multiple-bottom-line" does not replace but rather supplement the conventional bottom-line by measuring performance in all areas of EGSEE. Many companies issue sustainability reports to communicate with a variety of stakeholders on their EGSEE performance. Auditors in providing assurance on sustainability reports play an important role in identifying both strengths and concerns of sustainability performance and lend credibility to sustainability reports.

Globalization, technological advances and a move toward stakeholder theory of corporations have given impetus to the sustainability reporting movement. The overriding principles of sustainability are responsibility and accountability to all stakeholders and effective disclosures of EGSEE sustainability performance to such stakeholders. It appears that research and books in business sustainability are fragmented with a lack of an integrated approach covering all EGSEE. Moreover, different authors address one or more components of business sustainability without a comprehensive framework for interdisciplinary integration. Business sustainability practices required integrated approach of systematically addressing EGSEE.

Sustainability performance and accountability reporting have gained a new interest during the recent financial crises and resulted global economic meltdown. The ever-increasing erosion of public trust and investor confidence in sustainability of large businesses, the widening concern about social responsibility and environmental matters, overconsumption of natural resources, the global government bailout of big businesses and the perception that government cannot solve all problems of businesses underscore the importance of keen focus on sustainability performance and accountability reporting. The true measure of success for corporations should not only be determined by reported earnings, but their governance, social responsibility, ethical behavior, and environmental initiatives. Business sustainability education demands knowledge-based in business sustainability. Wouldn't you want to leave more resources for the next generation? Wouldn't you want your business to grow continuously? Wouldn't you want to govern your business effectively? Wouldn't you want to have an ethical and competent organization culture? Wouldn't you care about your corporate social responsibility, customers' and employees' satisfaction and ethical workplace? Wouldn't you care about green and lush environment? Wouldn't you care about profit, planet, and people? If you answer yes to any of the above questions, this book will be of interest to you.

PURPOSE OF THE BOOK

This book offers guidance to organizations that focus on sustainability performance and accountability reporting in reflecting their key performance indicators (KPIs) in all areas of EGSEE business affairs. For the purpose of this book, sustainability reporting refers to the ongoing process of identifying, measuring, recognizing, disclosing, and auditing sustainability performance in the five areas of EGSEE. Traditionally, organizations have reported their performance on economic affairs. Their focus only on financial results has become complicated and irrelevant to the extent that many corporate stakeholders find conventional financial reports less value-relevant. Furthermore, investor activisms, stakeholders, global organizations, and the public have increasingly demanded information on both financial and nonfinancial KPIs in this platform of accountability and sustainability reporting. This book examines the development of sustainability performance initiatives and strategies as well as sustainability reporting and assurance.

The primary theme of this book will be on the examination of sustainability performance and accountability reporting and their integration into strategy, governance, risk assessment, performance management, and the reporting process of disclosing governance, ethics, social, environmental, and economic sustainable performance. This book also highlights how people, business, and resources collaborate in a business sustainability and accountability model.

The emerging issues of sustainability performance, reporting, and assurance are integrated into all chapters. This book includes features, practical examples, and refinements valuable to professionals of all levels, corporate leaders, directors, and executives, as well as auditors, practitioners, and educators. This book is helpful to the following:

Auditors: External and internal auditors should find the chapter materials on sustainability EGSEE performance and reporting relevant, useful, and suitable to their audit functions, gearing their audit procedures toward providing sustainability assurance services. External auditors should expand their audit services beyond conventional audit of financial reports and provide assurance services on all five EGSEE dimensions of sustainability performance reporting.

Corporations, their board of directors, audit committees, executives, legal counsel, managers, supervisors, and employees: Business sustainability and sustainability performance, reporting, and assurance is becoming the theme of the 21st century, and corporate stakeholders have shown interest in and demand for sustainability EGSEE performance disclosures. Best practices of sustainability initiatives and strategies as well as sustainability reporting and assurance discussed throughout the book should help public companies and their board of directors, executives, financial advisors, and legal counsel effectively discharge their responsibilities and assume accountability for achieving sustainability performance.

Business schools and training programs: The book can also be utilized in educational and training programs of business schools, accounting programs, and professional organizations. Other professionals, such as compliance officers, management accountants, environmental activists, ethics and compliance officers, socially responsible activists, and financial institutions, who provide sustainability training services to corporations, will find this book useful to their professional services and activities.

Global sustainability professionals: Promotion of global sustainability performance, reporting, and assurance by high-profile organizations such as the Global Reporting Initiative (GRI) and International Integrated Reporting Council (IIRC) makes the book attractive to corporations, business schools, and professionals worldwide.

HIGHLIGHTS OF THE BOOK

Obviously, much is needed to be done in this emerging area of business sustainability performance, reporting, and assurance including a book covering the following important topics:

- Introduction to business sustainability performance.
- EGSEE dimensions of sustainability/accountability reporting.
- Sustainability assurance services.
- Roles and responsibilities of key players in sustainability reporting.

- Laws, regulations, rules, standards, and best practices governing sustainability reporting and assurance.
- Designing green business cutting-edge facilities and green accounting and reporting.
- Development, adoption, and implementation of sustainable technologies.
- Preparation of business sustainability and accountability reporting and assurance education.
- Regulatory reforms and best practices in the post-SOX and Dodd-Frank (DOF) era are integrated into all eleven chapters.

ORGANIZATION OF THE BOOK

The focus of this book is on sustainability performance, reporting, and assurance. The organization of the book provides the maximum flexibility in choosing the amount and order of materials on sustainability. This book is organized into three parts, as follows:

Part	Subject	Chapters
I	An Introduction to Sustainability Performance, Reporting, and Assurance	1–3
II	Dimensions of Sustainability Performance	4–9
III	Emerging Issues in Sustainability Performance, Reporting, and Assurance	10–11

Each chapter starts with an executive summary, an examination of real-world sustainability, and each chapter closes with a list of action items which helps the reader further identify how to apply the chapter's materials to sustainability performance, reporting, and assurance. The eleven chapters of the book are organized into three parts. The first part contains three chapters, which describe the importance of sustainability performance, reporting, and assurance. These chapters also present initiatives, rules, regulations, standards, and best practices of sustainability performance, reporting, and assurance. Part II, presented in chapters 4 through 9, discusses each of the five economic, governance, social, ethical, and environmental (EGSEE) dimensions of sustainability performance and reporting. These chapters constitute the foundation of the book. Part III includes two chapters, which present emerging issues and best practices of sustainability performance, reporting, and assurance. These chapters also discuss future trends in sustainability performance, reporting, and assurance.

Acknowledgments

WE ACKNOWLEDGE THE PUBLIC Company Accounting Oversight Board, American Institute of Certified Public Accountants, Global Reporting Initiative, and the Prince of Wales's Accounting for Sustainability Project, the International Integrated Reporting Committee, and the International Federation of Accountants, Securities and Exchange Commission, the United Nations, Canadian Institute of Charter Accountants, and Big Four Accounting Firms for permission to quote and reference their professional standards and other publications.

The encouragement and support of our colleagues at Ernst & Young and the University of Memphis are also acknowledged. Specifically, we appreciate the invaluable advice and insights from several colleagues at Ernst & Young, including Steve Starbuck, Chris Walker, Robert Brand, Chuck Glazer, and Jim Gaynor. We thank the members of the John Wiley & Sons, Inc., team for their hard work and dedication, including Chris Gage for managing the book through the production process, Andrew Wheeler for his marketing efforts, and Stacey Rivera and Tim Burgard for their editorial guidance.

Our sincere thanks are due to our families, the Rezaee family, Soheila, Rose and Nick; and the Brockett family, Mike, Zachary, Noah and Jacob. Without their love, enthusiasm, and support, this book would not have come to fruition when it did.

Ann M. Brockett
Zabihollah Rezaee

PART ONE

An Introduction to Sustainability Performance, Reporting, and Assurance

1

CHAPTER ONE

Introduction to Business Sustainability and Accountability Reporting

EXECUTIVE SUMMARY

In this chapter, we introduce the concept of business sustainability and corporate accountability, its importance, relevance, and its various components. The wave of financial scandals in the early 2000s, the 2007–2009 global financial crisis, and subsequent regulatory responses have galvanized considerable interest in business sustainability, corporate governance, ethical, and corporate accountability. Businesses and professional organizations worldwide have also responded by developing a business sustainability framework consisting of five overriding dimensions of economic, governance, social, ethical, and environmental (EGSEE) performance.

The most important and commonly accepted dimension of EGSEE is economic performance, which is the cornerstone of business sustainability. Organizations survive and produce sustainable performance when they continue to be profitable and produce enduring performance that creates shareholder value. However, EGSEE dimensions are not mutually exclusive, they supplement each other and trade-offs can occur between them. On one hand, organizations that are run ethically, governed effectively, and are socially and environmentally responsible are expected to maintain sustainable performance, create shareholder value, and gain public trust and investor confidence. On the other hand, more economically profitable and viable organizations are in a better position to create jobs and wealth, which enables them to better fulfill their social and environmental responsibilities. Although the primary goal of many business entities will continue to be creating shareholder value through producing sustainable economic performance, organizations must also effectively deal with ethical, social, and environmental issues to ensure they are adding value to all stakeholders involved.

INTRODUCTION

For business, sustainability is defined in several ways. For example, the 2010 United Nations' (UN) publication "Corporate Governance in the Wake of the Financial Crisis" broadly describes business sustainability as "conducting operations in a manner that meets existing needs, without compromising the ability of future generations to meet their needs and has regard to the impacts that the business operations have on the life of the community in which it operates and includes environmental, social and governance issues."[1] The UN report further links business sustainability to corporate governance and suggests that sustainability information pertaining to social, governance, ethical, and environmental issues be incorporated with financial information in a single report that includes professional assurance on sustainability information.[2] The 2009 International Federation of Accountants' (IFAC) "Sustainability Framework" makes a similar recommendation. The IFAC suggests that sustainability be integrated into all aspects of business models from strategic decisions to operations, performance, and communication with stakeholders.[3] The IFAC's approach as described in "Sustainability Framework" addresses four different perspectives: "business strategy, internal management, investors, and other stakeholders."[4] Corporate sustainability can be summed up as conducting business to create value for present shareholders while protecting the rights of future shareholders and stakeholders.

Sustainability is a dynamic term that can be applied to various purposes and in a variety of settings. The modern use of the term *sustainability* was first developed in 1987 by the World Commission on Environment and Development (WCED)—also known as the Brundtland Commission—in a UN-sponsored study entitled *Our Common Future*. WCED described sustainability as an approach that "meets the need of the present without compromising the ability of future generations to meet their needs."[5] This captures a key component of sustainability—it is a process of establishing appropriate strategies, policies, and procedures that satisfy present needs without jeopardizing the future.

A program or an activity is considered sustainable if it meets all of the following criteria:

- Creates economic value.
- Increases public wealth with proper mechanisms for its distribution.
- Socially justified.
- Environmentally sound.
- Ethically conducted.
- Conforms to all applicable laws, rules, and regulations.

Several recent reports and publications, such as those by the United Nations Environment Programme Finance Initiative (UNEP FI) and the Canadian Institute of Charter Accountants (CICA), have discussed various aspects of sustainability performance in the areas of social, ethical, governance, and environmental sustainability.[6] In this book we add one more important dimension: making a sustainable profit through transparent economic performance.

THE CASE FOR SUSTAINABILITY

The 2007–2009 global financial crisis was caused by many factors, including inadequate risk assessment and management, ineffective corporate governance, and a strong focus on achieving short-term performance. Sustainable practices correct each of these failures and lead to long-term growth. Sustainability addresses all aspects of business and markets, from strategic decisions to operations, performance, and disclosures of sustainability information to investors and financial markets that could in turn prevent future economic, social, ethical, governance, and environmental crises. Integrated business practices and reporting are key factors in fostering sustainability.

Southwest's "One Report"

The first step to sustainability is transparency. Southwest Airlines annually issues the "Southwest Airlines One Report," which was initiated in 2009 to integrate the management report on financial statements with environmental disclosures and information on other aspects of operational sustainability. This integrated report focuses on meeting expectations regarding shareholders, customers, employees, and the environment by disclosing financial and nonfinancial key performance indicators (KPIs) on all aspects of sustainability.

Southwest examines the impact of business practices concerning financial decisions, suppliers, and employee training outcomes, as well as the company's environmental, social, and community impact. Southwest realizes benefits from integrated reporting through more effective and transparent communication with all stakeholders, which reflects the airline's commitment to high-quality service and good corporate citizenship beyond fulfilling its fiduciary responsibilities. It also establishes accountability, which is another key of corporate sustainability.

The 2010 "One Report" contains forward-looking information, disclosing the company's estimates, expectations, beliefs, intentions, and strategies for the future, though this cannot guarantee future performance. The report illustrates the continued steadfast focus on the triple bottom line—the performance (profit), the people, the planet—and conforms to the principles outlined by the Global Reporting Initiative (GRI).[7] Southwest Airlines intends to continue releasing its Southwest Airlines One Report on an annual basis.

CURRENT STATUS OF SUSTAINABILITY AND ACCOUNTABILITY

Several recent surveys have underscored the emergence of sustainability within the global business sustainability community. A study conducted by Ernst & Young in cooperation with GreenBiz Group in 2012 analyzed results from 272 executives and leaders of 24 business sectors in corporate environmental strategy and performance. The study revealed six key trends:

1. Sustainability reporting is growing, but the tools are still developing.
2. The CFO's role is increasing.
3. Employees emerged as a key stakeholder group for programs and reporting.
4. Despite regulatory uncertainty, greenhouse gas reporting remains strong along with growing interest in water.
5. Awareness is rising on the scarcity of business resources.
6. Sustainability performance rankings and ratings matter to company executives.[8]

This report sheds light on the profound shifts taking place in corporate sustainability as efforts move from purely voluntary programs that, while not mandated by laws or regulations, have become de facto requirements due to the expectations of customers, employees, shareholders, and other stakeholders.

These expectations are raising the bar for the quality of reporting and raising risks for companies whose disclosure and transparency do not hold up to scrutiny.

The Ernst & Young Survey reinforced findings from an earlier KPMG 2010 survey. The KPMG survey included 378 senior executives worldwide and revealed amongst its findings that about 62 percent of surveyed companies have a strategy for sustainability compared to 50 percent in 2008; roughly 5 percent have no plan for implementing corporate sustainability and the remaining companies were in the process of establishing such a plan. In addition, more than 42 percent of surveyed executives indicated that sustainability is a source of innovation, whereas 39 percent agreed that sustainability is a source of new business opportunities and growth.[9]

Organizations interested in producing reports to showcase their sustainability actions and commitments should address seven questions related to best practices, voluntariness, content, mechanisms, value relevance, and assurance of sustainability reports, as suggested by Ernst & Young (2010).[10] The questions are:

1. Who issues sustainability reports? (Best practices)
2. Why report on sustainability if you do not have to? (Voluntary)
3. What information should a sustainability report contain? (Content)
4. What governance systems and processes are needed to report on sustainability? (Mechanisms)
5. What are the challenges and risks of sustainability reporting? (Assessment)
6. Do sustainability reports have to be audited? (Assurance)
7. How can companies get the most value out of sustainability reporting? (Value relevance).

In June 2012, Brazil, Denmark, France, and South Africa formed a group to promote sustainability reporting in support of paragraph 47 of the UN Conference on Sustainable Development.[11] It is expected that other developed and developing countries join this group in requiring their listed companies to issue sustainability reports.

DRIVERS OF SUSTAINABILITY INITIATIVES AND PRACTICES

The Kyoto Protocol of the United Nations Framework Convention on Climate Change (UNFCCC) was a commitment by nations to reduce their Greenhouse Gas emissions to address global warming. The Protocol was adopted on

December 11, 1997, in Kyoto, Japan, and went into effect on February 16, 2005. The UNFCCC is an international environmental treaty with the specific objective of "stabilization of greenhouse gas concentrations in the atmosphere at a level to prevent dangerous anthropogenic interference with the climate system."[12] A detailed discussion of the Kyoto Protocol Framework and its implications for business sustainability is further discussed in Chapters 9 and 10.

The topic of sustainability is evolving and initiatives are growing around the world. With increasing pressure on energy and commodity prices and growing scarcity of raw materials, sustainable development is essential to ensuring the future viability of organizations. Also, increasing consumer demand and regulatory initiatives make sustainable development more attractive from a fiscal perspective. The 2010 United Nations Global Compact/Accenture study indicates that 93 percent of the 766 global CEOs reported sustainability as either an "important" or "very important" factor for the future success of their organizations and about 81 percent declared that sustainability issues are integrated into their organizations' strategy and operations.[13] Furthermore, consumer preferences drive organizations to seek sustainable development in order to remain competitive. As consumers become more educated about sustainable initiatives, they have come to expect changes in how products are produced and packaged. An increasing number of consumers are seeking out those organizations that demonstrate an awareness and concern about sustainability issues. Many consumers expect sustainable attributes to be an integral part of the products and services they buy.

Regulatory reforms and standards are also driving sustainability initiatives for organizations. With an increasing amount of pressure from the public, legislators have begun to mandate social responsibility and environmental sensitivity. As an example, the reduction of a company's carbon footprint, as part of the Kyoto Protocol, has driven companies worldwide to consider the climate change impact of their operations and develop strategies around reducing that impact over time.

A move toward the stakeholder theory implies that business organizations have obligations to a number of constituencies and thus should add value for all stakeholders including shareholders, creditors, suppliers, customers, employees, government, environment, and society. Conventional shareholder theory, however, implies that the primary goal of a corporation is to create shareholder value in a single objective function of maximizing financial performance. Business sustainability promotes application of