Bruce Pounder, CMA, CFM, Editor

Trends in Sustainability Reporting

As sustainability becomes an increasingly common subject of corporate reporting, financial managers should be aware of emerging trends.

The word "sustainability" means different things to different people. In some cases, sustainability refers to "hard" realities of contemporary business, such as an organization's economic performance or risk-management practices. In other cases, sustainability refers to "soft" matters, such as corporate social responsibility or gender issues in the workplace. In still other cases, sustainability refers to how an organization affects—and is affected by—its physical environment.

As organizations throughout the world engage in more activities related to the many aspects of sustainability, they are increasingly publishing reports on those activities and their outcomes. In this month's column, I'll identify four key trends that reflect substantial changes in what and how organizations are reporting with regard to sustainability. I'll also identify some significant implications of those trends for financial managers.

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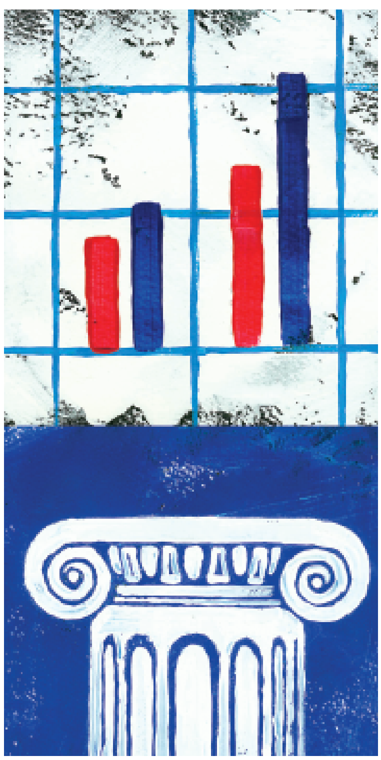
Background

According to an October 2010 research report by Ernst & Young, more than two-thirds of the *Fortune* Global 500 companies now produce some form of sustainability or "corporate responsibility" report (www.ey.com/climatechange). Some of those reports are mandatory. For example, a standard recently issued by the U.S.-based National Association of Insurance Commissioners (NAIC) requires insurance companies to disclose the financial risks they face because of climate change.

But most sustainability reports are published on a voluntary basis.



As *Fast Company* blogger Patti Prairie notes, an "overwhelming majority of *Fortune* 500 companies now voluntarily measure, manage, and publicly disclose their carbon emissions…" (www.fastcompany.com/1714526/the-four-keys-to-corporate-sustainability-in-2011) In the vernacular of sustainability, "carbon" refers to carbon dioxide, a greenhouse gas that has been linked to global warming.

Regardless of whether an organization chooses to or is required to report on sustainability, such reporting has many practical benefits. Specifically, 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.

Though many individual and organizational stakeholders influence the sustainability-reporting practices of business entities, the most influential stakeholders are present and potential investors. Investors are, in turn, decreasingly influenced by an entity's financial performance alone and increas-

ingly influenced by their perception that sustainability is critical to an entity's financial performance and to fulfilling the implicit contract between the entity and society.

Four Trends

The first trend that we can observe in sustainability reporting is *escalation*. In short, both the quantity and quality of the sustainability information that organizations report are increasing. Quantitatively, more organizations are reporting sustainability information, and more sustainability information is being reported by each organization. Qualitatively, reported sustainability information is becoming more substantive, longer term in nature, and more focused on the external impact of organizations' sustainability practices rather than on the practices themselves.

The second trend in sustainability reporting is *integration*, which has two dimensions. First, diverse kinds of information that have traditionally been reported separately are increasingly being reported in an integrated manner. Second, corporate reporting increasingly reflects the integration of sustainability considerations into managerial decision making. For example, the Johannesburg (South Africa) Stock Exchange recently enacted a compulsory "comply or explain" rule for listed companies to produce an integrated report that shows how sustainability issues impact corporate strategy and value creation.

Standardization is the third trend. Stakeholders will continue to form and express opinions on what sustainability information organizations should report and how. In cases where a pervasive consensus among stakeholders has been reached, "best practices" in sustainability reporting have emerged. And from those best practices have emerged various frameworks, guidelines, and standards for sustainability reporting. Increasing standardization brings improvements in consistency and comparability, which stakeholders value.

Trend four is *globalization*. Sustainability issues and sustainability reporting aren't limited to organizations in one country or region; rather, each of the preceding trends—escalation, integration, and standardization—is playing out on an increasingly global scale. As the global financial crisis has emphasized, business entities and whole economies are highly interconnected across national borders.

The Trends in Action

To connect these trends to specific, real-world developments, let's now briefly examine three initiatives at the vanguard of sustainability reporting: the Global Reporting Initiative (GRI) at www.globalreporting.org, The Prince's Accounting for Sustainability Project (A4S) at www.accountingforsustainability.org, and the International Integrated Reporting Committee (IIRC) at www.theiirc.org.

GRI, which is based in The Netherlands, began in 1997. Its chief work product is a sustainability reporting framework that consists of:

- Sustainability Reporting Guidelines (guidance on how organizations can disclose their sustainability performance),
- Sector Supplements (industry-specific performance indicators),
- The Technical Protocol (process guidance on defining the content of a sustainability report), and
- National Annexes (country-specific information).

In October 2010, GRI opened an office in New York City. The aim of "Focal Point USA," as the office is known, is to "boost the quality and quantity of sustainability reports coming from U.S. organizations." GRI has also established similar "Focal Points" in Australia, Brazil, China, and India. And on November 9, 2011, GRI introduced its Sustainability Disclosure Database that provides information about and access to the sustainability reports of more than 3,000 companies worldwide.

A4S was established by His Royal Highness The Prince of Wales (Prince Charles) in 2004. As noted on its website, A4S "works with businesses, investors, governments and other stakeholders to achieve the step change in corporate reporting, accounting and decision-making needed to underpin a sustainable, resilient economy." To date, key outputs of the project include several research reports and face-to-face discussion forums.

In August 2010, GRI and A4S formed the IIRC to "[c]reate a globally accepted framework for accounting for sustainability: a framework which brings together financial, environmental, social and governance information in a clear, concise, consistent and comparable format." One of the IIRC's most significant work products has been a discussion paper, *Towards Integrated Reporting—Communicating Value in the 21st Century*, containing a draft framework, which was issued September 12, 2011. More recently, on October 26, 2011, the IIRC announced that more than 40 participants have been accepted into its new "Pilot Programme, [through which] the principles and practicalities of Integrated Reporting will be tried and tested." Participants include Microsoft, HSBC, Novo Nordisk, and The Coca-Cola Company.

Implications for Financial Managers

The four trends in sustainability reporting have important implications for financial managers, especially in the areas of investor relations and, more broadly, public relations. In particular, financial managers should understand that telling a company's financial story is increasingly likely to involve telling the company's sustainability story. At the same time, the audience for corporate reporting is expanding from investors, lenders, and securities-market regulators to virtually everyone. What's more, users of integrated reports are moving beyond just absorbing the information in such reports and are increasingly evaluating, comparing, and either praising or vilifying reporting entities on the basis of that information.

As the trends identified in this column continue, corporate reporting in the United States and around the world will change significantly. Fortunately, the coming changes are largely predictable, which enables managers to prepare themselves and their organizations. Initiatives such as GRI, A4S, and the IIRC offer a wealth of free resources to help. **SF**

Bruce Pounder, CMA, CFM, DipIFR (ACCA), is vice president, Accounting Programs, for SmartPros Ltd. He is also the immediate past chair of the IMA® Small Business Financial and Regulatory Affairs Committee. You can reach him at BrucePounder@SmartPros.com.