Sustainability Reporting: Earth in the Balance Sheet

Sustainability reports offer plenty of eye candy, but can they actually help managers make better decisions?

Scott Leibs/CFO Magazine

Three weeks before Al Gore won the Nobel Peace Prize for his efforts to sound the alarm on climate change, a coalition of investors, state governments, and environmental groups was sounding an alarm of its own. It petitioned the Securities and Exchange Commission to require publicly traded companies to disclose more data on the potential financial impacts of climate change. The coalition argues that the risks companies face regarding climate change are now material to shareholder investment decisions and should be disclosed under existing law.

That clamor may surprise anyone who has followed the rise of "sustainability reporting," the practice of publicizing a company's environmental and social risks, responsibilities, and opportunities. While sustainability is difficult to define, it has been a corporate buzzword for at least two decades. And for the past six years, companies have had at least one formal framework to follow when communicating their sustainability efforts and exposures, that of the Global Reporting Initiative (GRI), an Amsterdam-based nonprofit organization comprising business, government, social advocacy, and other stakeholders.

Now in its third iteration, the GRI framework has brought increasing levels of rigor to the practice of sustainability reporting by providing guidance on everything from how to craft a broad statement of strategy to which specific performance indicators to measure in six comprehensive categories (from environmental issues to human rights to product safety). More than 1,200 companies have followed the GRI framework, and hundreds of others produce sustainability reports based on other guidance or their own criteria.

A sustainability report can be thought of as an environmental-impact statement for the entire corporation, with "environment" defined not only in terms of natural resources and climatological effects but also the economic and social impacts of labor practices, charitable endeavors, and governance structures. PepsiCo CEO Indra Nooyi summarizes the sustainability movement as "performance with a purpose," and has told audiences that "there is no escaping that our businesses are inextricably and profoundly linked to the world and the people around us."
Quantifying those many links is not easy, but the GRI framework has, over the years, become much more detailed regarding the performance indicators that companies are urged to measure and monitor. In the "emissions, effluents, and waste" subcategory, for example, the framework advises companies to report "total direct and indirect greenhouse-gas emissions by weight," and "total weight of waste by type and disposal method." In all, the framework identifies nearly 80 indicators, many of which can be further broken down into further subcategories.

That might lead CFOs to believe that a typical sustainability report is chock full of tabular data detailing everything from CO2 emissions to product recalls to employee turnover. In truth, most sustainability reports are light on numbers and heavy on photographs. "There are lots of pictures of butterflies, lakes, and mountains," says Mikko Valtonen of Proventia Solutions, "because often these reports are prepared by environmentally focused employees in the public-relations department" keen to burnish a company's pro-environmental image.

And not without reason. Sustainability reporting is in many ways a response to the long-standing push for socially responsible investing. As specialized mutual funds and institutional investors began to ask senior management not only about the size of the bottom line but also the manner in which it was achieved, companies responded by providing more information on a host of environmental and social practices. "But companies have often been pulled in two directions," says Sean Gilbert, technical director at the GRI. "Some analysts want hard data in an accessible format that allows for uniform comparison, but other investors want a narrative around strategic issues supported by limited data."

**In Search of Value**

Companies to date have tended to split the difference. Take Koch Industries Inc., the Wichita-based conglomerate with operations spanning oil, chemicals, cattle ranching, and textiles. Its most recent sustainability report is rife with photos of forests, duck eggs, and kids with butterfly nets, but it also provides graphs that detail its emissions volumes, oil leaks, and other data points.

The trouble with most reports, says Judy Kuszewski, director, client services, with London-based consultancy SustainAbility Ltd., is that "they have no natural audience other than a handful of SRI [socially responsible investing] analysts, most of whom would rather get the information in a meeting than a report."

But producing sustainability reports is not, Kuszewski adds, a hollow exercise. "They get management focused on these issues," she says, "and they create a process for gathering and reporting data." A better process for producing the reports could result in something that not only looks nice, but also provides more information to investors, employees, and other interested parties.
Most reporting efforts historically have been intensely manual, but many experts say a change is under way as companies begin to explore the possibility of automating at least a part of the process. The goal is to not merely speed up the production of such reports and make them more data-rich, but to transform them from a triumph of corporate communications to a useful tool for management.

"For reporting to be of the most value," says the GRI's Gilbert, "you need to have no gap between the information you report out and the information you use internally. So we're seeing a clear shift toward the greater use of IT, with ERP and other software vendors now extending their products to address sustainability reporting."

The movement is most pronounced in Europe, where regulatory demands regarding carbon trading and other environmental issues are forcing companies to abandon the glossy brochure in favor of more-substantive and -detailed reporting. "We've seen a marked change in just the last 6 to 12 months," says Proventia Solutions's Valtonen. "Companies are realizing that they must now report on a wide range of nonfinancial indicators, but those same indicators have genuine financial impact, so they want to integrate this sustainability data into their daily operations."

Proventia offers software that does precisely that, either in a stand-alone version or in a version that works with performance-management software from Hyperion (recently acquired by Oracle). Oracle, SAP, SAS Institute, and other software companies see opportunities in integrating financial and nonfinancial data into systems that address sustainability and related reporting needs such as compliance and governance.

"Once companies start to capture this data more efficiently," says John O'Rourke, senior director of product marketing at Oracle, "they realize that it can function like 'traditional' performance management, in that it gives them current information they can actually use to make decisions about emissions, energy usage, and other critical business matters."

Valtonen says that one client, a plastic-packaging manufacturer, gathered data on the energy used in three different modes of manufacture and realized that one technique was 12 times more efficient than another, prompting the company to embrace the superior method more widely.

Patricia Finn, vice president of Global Public Policy for SAS, says that while some of the company's customers are applying performance-management and business-intelligence software to sustainability reporting, "the uptake has been slow." SAS is working with the Organization for Economic Cooperation and Development and the World Economic Forum to develop a common reporting standard or set of metrics, which Finn believes will lead to a greater embrace of IT — and better reporting. "If one company plants a tree for every car it sells, and another cuts its water use by 25 percent, who's more green?" she says. "There is a lot of gimmickry out there right now."
Investors Want More Data

While the GRI framework is widely used, it is not an officially sanctioned standard. Nonetheless, the GRI may further propel the quality of sustainability reporting through the addition of XBRL (extensible business reporting language), which facilitates the gathering and analysis of business-performance data by assigning a "tag" (a small piece of code) to each piece of data.

The GRI has created an XBRL taxonomy for the many indicators itemized in its sustainability framework. This will greatly aid a more automated approach to sustainability reporting in much the same way that the SEC believes XBRL will aid the production and dissemination of financial reports.

In fact, the use of XBRL for sustainability reporting may drive a nascent but promising trend: the combining of standard financial data with sustainability data in a single annual report. A handful of companies already do this, and Eric Israel, a managing director at KPMG, believes more will follow suit. "There is a serious need for IT support to make this happen," he says. "It's missing now, but as expectations change and sustainability reporting becomes less about PR and more about satisfying investors' need for data, more automation will become essential."

Although that might seem to be a mandate for a company's chief information officer, Israel believes that CFOs may well drive the trend. As reports encompass more data, he says, "you have to ask whether a public-relations person or an environmental-affairs person is best qualified to verify whether the data is accurate and up-to-date. That's really an area of expertise for CFOs and finance departments." He expects to see CFOs play a stronger role going forward.

Changing as well is the role of audit firms. Increasingly, they are being asked to provide third-party assurance regarding at least a portion of the data contained in sustainability reports. Suncor Energy Inc., for example, says that more than 80 data points in its voluminous 2007 sustainability report (which weighs more than a pound and, while containing photos of lakes and windmills, also has five years' worth of data on a wide range of performance indicators) were verified by an outside auditor.

But Suncor's data-rich and externally verified report is hardly a product of automation. While the company does pull some data from its ERP system, it painstakingly assembles the bulk of its report from spreadsheet data. "We have to tap about 50 to 100 people internally to get everything we need," says Suncor spokeswoman Darcie Park. "It's a fairly labor-intensive process."

Yet that hasn't prevented Suncor from being listed on the Dow Jones Sustainability World Index, which tracks approximately 300 global companies deemed to be at the forefront of sustainability efforts. In fact, companies can make that list without producing a sustainability report at all. Health-care giant Humana, a recent addition, is only now beginning to assemble what David Noltemeyer, governance manager for its
Workplace Solutions team, says will be "a very comprehensive reporting package." Noltemeyer says that Humana has been focused for years on what is often termed the "triple bottom line" (a management philosophy that seeks to balance economic, environmental, and social concerns), and he believes that better reporting will "provide a more comprehensive picture for managers to base decisions on."

Humana has even talked to its IT department about the issue — but not in the way that software vendors might hope. "Our discussions with IT so far have focused on energy consumption and the recycling of IT equipment," Noltemeyer says, "but not data collection." That's not to say that as the company ramps up its efforts it won't look to automate the process where it can, but with sustainability encompassing so many departments and so many facets of operations, a focus on the means of data collection and analysis does not seem to be top of mind for all companies.

For those ready to take sustainability reporting to the next level, however, the evolving maturation of the GRI model, the addition of an XBRL taxonomy, the push for global standards, the increasing pressure for companies to report on climate data, and an extension of current software capabilities may provide plenty of incentives to adopt a more automated approach. "Expectations for sustainability reporting are evolving quickly," says KPMG's Israel. "Companies that continue to view it as merely a PR exercise will hurt themselves."

Last month, New York Times columnist Thomas Friedman suggested that the need for data-crunching on energy consumption, CO2 emissions, and related environmental metrics could trigger a fresh wave of outsourcing to India. Others believe that such reporting is too critical to farm out.

"If this is something that's truly important to your business," says Oracle's O'Rourke, "you should set goals, establish metrics, and monitor your progress against them." For that to happen, companies will need to focus less on the report and more on the reporting, conceiving of it as a continuous activity that is as critical to running the business as it is to selling the business.

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