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How to Report a Company's Sustainability Activities

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BY COMBINING TWO METRICS, MANAGEMENT ACCOUNTANTS CAN CREATE A COMPREHENSIVE METHODOLOGY FOR REPORTING A COMPANY'S USE OF ECONOMIC, ENVIRONMENTAL, AND SOCIAL RESOURCES.

"What is sustainability? It's more than environmentalism. It's about living and working in ways that don't jeopardize the future of our social, economic and natural resources. In business, sustainability means managing human and natural capital with the same vigor we apply to the management of financial capital. It means widening the scope of our awareness so we can understand fully the 'true cost' of every choice we make."—Ray Anderson, founder of Interface, Inc.

More and more, corporations and other organizations are reporting their "sustainability" activities—their responsibilities to keep the environment clean, treat people humanely, and achieve economic goals. In fact, sustainability reporting has become a vital part of the information that external and internal decision makers use. "For many corporations, sustainability is becoming not just 'a nice thing to do' but a core requirement, enabling them to increase their value and sustain profitability in the long term," Willem Bröcker of PricewaterhouseCoopers (PwC) says.[1] Sustainability reporting includes economic, environmental, and social indicators that help monitor progress toward sustainable practices. Eighty-one percent of senior executives at large U.S.-based businesses report that sustainability practices will be essential or very important to their company's strategic mission.[2] That may be because the way a company manages its social and environmental responsibilities influences its financial success.[3]

In this article I will discuss the emergence of sustainability reporting as a major source of information for external decision makers. I will pay special attention to the Global Reporting Initiative's (GRI) *Sustainability Reporting Guidelines* and how they fit into the balanced scorecard (BSC).

EMERGENCE OF SUSTAINABILITY REPORTING

Sustainability reporting is becoming a mainstream practice.[4] Sustainability reports had primarily addressed environmental issues until 1999, when they began to include economic and social indicators as well. Fewer than 100 U.S. companies issued sustainability reports in 1993, but that number had grown to 1,500 by 2005.[5] That figure includes 68% of the top 250 companies in the *Fortune* 500.

The increase in sustainability reporting has not gone unnoticed by the investment community. Since 1999, the Dow Jones Sustainability Indexes (DJSI) have been tracking the financial performance of companies that are "sustainability driven." In addition, the Dow Jones STOXX Indexes and Sustainable Asset Management provide asset managers with benchmarks to manage portfolios of issuers who practice sustainability.

More than 50 asset managers in 14 countries are using the DJSI to manage €3.6 billion.[6] The number of investment management companies that are evaluating companies' sustainability practices illustrates that, for investment purposes, some external users are no longer satisfied with historical financial reports as the predominant source of a company's reported information.

Increased scrutiny of corporate behavior is being demanded by consumers, governments, employees, and local communities as well as investors. Large companies have a substantial impact on the people in their communities and on their employees. Corporate misbehavior is costly in many ways. It can harm workers, cultures, and the environment. Ultimately, corporate misbehavior damages reputations and profits. For example, in 1996, Nike suffered a consumer backlash, a boycott, and long-term damage to its reputation because it employed children to manufacture its products in Pakistan. Reports of poor working conditions and pollution in Nike's factories in Vietnam also plagued the company. Many other large companies also have come under scrutiny for their treatment of workers. For example, Wal-Mart's stakeholders have demanded more transparency because of the company's employee compensation practices.

Sustainability reports can provide some of this transparency. Stakeholders are increasingly interested in evaluating profits and the processes that create them because processes that involve innovation, production, and worker and consumer safety are influenced by a company's values about the environment and financial and human capital. Jeffrey Immelt, GE's chairman and CEO, views execution, growth, great people, and being a good corporate citizen by helping to solve world problems as drivers of GE's success. Its practices of global citizenship affect how GE operates and treats its employees, the kinds of companies and countries it chooses to do business with, and the technologies it invests in, Immelt said in a news report.[7] For example, GE is making better energy-efficient locomotives to protect the environment along with requiring supply-chain audits to protect against the use of sweatshops. These values are important to stakeholders and can be communicated in terms of sustainable practices in sustainability reports. By embracing sustainable development, companies can improve their competitiveness, performance, and image.[8]

Another indication of the emerging relevance of sustainability reporting is the direct involvement of major public accounting firms. For example, KPMG in the U.K. offers a variety of services related to sustainable development: public opinions on environmental and social reports, assurance on environmental and social management systems, and advisory services (risk management, performance measurement, and reporting) in relation to "hot issues" in the marketplace, such as climate change, emerging standards and regulations, supply-chain risks, human rights, and stakeholder activism. PwC offers similar services. It sees sustainable reporting as a fast-growing market and an opportunity to expand its business.[9] The major accounting firms are already performing 65% of the verifications of companies' sustainability reports, a report from KPMG's Global Sustainability Services said.[10]

Verifications of these reports are not the same as an audit of financial statements because sustainability reports are published in a variety of formats. Unlike generally accepted accounting principles (GAAP), there are no generally accepted standards of sustainability reporting. In most instances, sustainability reports cover a company's economic, environmental, and social activities, but not all companies use the same indicators to gauge their activities, and this makes comparison difficult.

To address this consistency problem, the Global Reporting Initiative, an independent institution, offers sustainability reporting guidelines that help make the reports more standardized.[11] The GRI began in 1997 and became independent in 2002. It is an official collaborating center of the United Nations Environment Programme. To develop reporting guidelines, the GRI works with representatives from business, accounting, investment, environmental, human rights, research, and labor organizations from around the world. There are 665 organizations that report their sustainable activities in accordance with the GRI's *Sustainability Reporting Guidelines*.

Sustainability Reporting and the Balanced Scorecard

Sustainability reports also help internal users better manage risks associated with environmental and social incidents. Rather than reacting to problems as they arise, managers can engage in proactive strategies to reduce problems. Many corporations report that adopting sustainable practices and reporting them reduces operating costs, improves efficiency, improves their reputation, helps them develop innovative products and services, and integrates risk management.[12] For example, Canon Corporation has been redesigning its production processes and products to reduce the use of hazardous materials to meet the company's environmental performance targets. Meeting its environmental targets results in progress toward economic and social objectives by reducing costs and increasing worker safety, respectively. One specific change in Canon's production process involves the production of lead-free cables for all of its printers.[13] By not using lead, Canon is able to reduce its costs, lessen the negative impact on the environment, and provide a safer workplace.

Although the *Sustainability Reporting Guidelines* are not a management system, they can provide companies with an approach to achieving sustainable practices that involves the entire company. Involving the entire company increases the likelihood of achieving successful outcomes. Many initiatives in managerial accounting, such as total quality management (TQM), activity-based costing (ABC), just-in-time (JIT) production and distribution systems, and reengineering, appeared promising but did not produce the desired economic benefits.[14] In many companies, the programs were fragmented and not tied to the overall corporate strategy. This could be the fate of sustainability reporting if it is not viewed from a strategic management viewpoint.

The balanced scorecard is considered a strategic management system that ties financial and nonfinancial performance measures to the overall mission of the organization. The measures on a BSC should be used to "articulate the strategy of the business, to communicate the strategy of the business, and to help align individual, organizational, and cross-departmental initiatives to achieve a common goal," according to Robert Kaplan and David Norton.[15] The BSC was not intended to be a system to achieve compliance with a predetermined plan but a system that fosters communication, informing, and learning. It is a set of measures derived from a top-down process and driven by the mission and strategy of the company.

By incorporating the GRI sustainability indicators into the BSC, organizations can easily tie their sustainability measures to their overall mission. Sustainability practices can be instituted throughout a company with the intent of achieving an integrated strategy of sustainable development. Measurements involving the four perspectives of the BSC (financial, customer, internal business processes, and learning and growth) can be combined with the three components of sustainability reporting (economic, environmental, and social). This combination could result in obtaining the most from the external measures intended for shareholders and customers and the internal measures of business processes, innovation, and learning and growth.

Let's examine the GRI's *Sustainability Reporting Guidelines* in connection with the BSC's four perspectives.

First, the balanced scorecard measures of financial performance are revenue growth and mix, cost reduction/productivity improvement, asset utilization/investment strategy, and risk management, and they are aimed primarily at how a "company's strategy, implementation, and execution are contributing to bottom-line improvement."[16] The BSC customer perspective includes core customer outcome measures such as satisfaction, loyalty, retention, acquisition, and profitability. In the BSC internal business processes perspective, objectives and measures are derived from explicit strategies to meet shareholder and targeted cus-

Table 1: Snapshot of Where Balanced Scorecard Perspectives Intersect with Economic Sustainability Indicators

Economic Sustainability Indicatotrs†	Balanced Scorecard Perspectives*				
	FINANCIAL				CUSTOMER
	Revenue and Growth	Cost Reduction	Asset Utilization	Risk Management	Retention, Acquisition, and Profitability
Customer	✓				
Suppliers		✓		✓	
Employees		✓	✓		
Providers of Capital		✓			
Public Sector					✓

* Robert S. Kaplan and David P. Norton, *The Balanced Scorecard*, Harvard Business School Press, Boston, Mass., 1996.

† Global Reporting Initiative, *Sustainability Reporting Guidelines*, Boston, Mass., 2002.

tomer expectations. Kaplan and Norton recommend a value-chain model that includes innovation, operations, and post-sale service. In the learning and growth perspective, the BSC develops objectives and measures to help achieve the objectives in the financial, customer, and internal business processes perspectives. The three principal categories for learning and growth are employee capabilities, information systems capabilities, and alignment and empowerment.

The BSC complements the sustainability goals of continuously improving financial performance (growth and value creation), environmental performance (integrating environmental and bioethical considerations), and social performance (integrating social, human rights, and health and safety). Many of the GRI indicators correspond to the financial, customer, internal business, and the learning and growth perspectives of the BSC.

Economic Indicators

Rather than measuring changes in the organization, GRI economic performance measurements track economic changes that result because of an organization's sustainability activities that affect stakeholders. Although the GRI economic indicators are similar to the BSC financial perspective, they are broader. They focus more on the way an organization affects the stakeholders with whom it has direct and indirect economic interactions. For example, the GRI categorizes economic indicators in terms of stakeholders: customers, suppliers, employees, providers of capital, and the public sector, as shown in Table 1. This reporting blends the needs of the external and internal users because it enables external users to monitor progress toward sustainability, and internal users can identify areas that need corrective action.

The GRI economic indicators involving customers include net sales and geographic breakdown of markets. Companies report their net sales by geographic region and type of product. From an internal perspective, managers are able to monitor whether they are on target for their financial goals in each of these markets. From a BSC financial perspective, GRI economic indicators correspond to revenue growth and sources of revenue. They can also be tied to the BSC customer perspective, which measures profitability of the core customer. Stakeholders can also determine where the customer base is and what financial impact the company is having in different regions worldwide. This information is also relevant to risk assessment from both external and internal viewpoints. Unpredictable events in different parts of the world can have a dramatic impact on a company's profits. For instance, if war or natural disaster affects a particular region of the world, a company's risk exposure to loss can be assessed by analyzing its customer base in that location.

Economic indicators for suppliers are cost of all goods, materials, and services that suppliers provide and the percent of contracts that are paid in accordance with agreed terms, excluding agreed penalty arrangements. These indicators could help with cost reduction and with risk management in the BSC financial perspective. The cost of goods, materials, or services is often a major component of a company's expenses and can be evaluated in terms of its impact on profits. Whether a company is complying with contract terms helps internal and external users evaluate contract risk.

Indicators for employees are total payroll and benefits, such as wages, pension, and other benefits, broken down by country or region. From the BSC financial perspective, these indicators can be categorized under cost reduction and risk management. Internal users can monitor and control these costs for specific countries and regions. Stakeholders can assess the impact that the company has as a provider of employment and wealth to workers in different regions of the world. Stakeholders may be able to determine whether fair wages are being paid according to the standards of specific countries. Failure to pay fair wages puts a company at risk for charges of exploitation and may damage its reputation.

Indicators about capital providers show distributions to creditors and shareholders. These indicators are interest on debt and borrowings; dividends on all classes of shares, with any arrears of preferred dividends to be disclosed; and the change in retained earnings at the end of the period. The last item includes return on average capital employed, one of the BSC's financial measurements. Payments for interest can affect profitability, and their reduction would be considered part of cost reduction goals in the BSC.

The public sector indicators include total sum of taxes of all types paid, broken down by country; subsidies received, broken down by country or region; and donations to community, civil society, and other groups, broken down in terms of cash and in-kind donations per type of group. These payments are a measure of the financial impact that a company has on the local economy through taxes and contributions. For example, in its sustainability report for 2003, British Petroleum reported its total charitable contributions as $74.4 million, broken down by projects in different countries. Many companies make these donations to local communities to generate goodwill, which can be viewed as an objective of the financial perspective of the BSC, measured by new local customer acquisition or revenue growth in the local communities.

Environmental Indicators

GRI environmental indicators are divided into materials, energy, water, biodiversity, emissions, effluents, waste, products and services, and compliance, as shown in Table 2. These environmental sustainability indicators are then subdivided. For example, materials—other than water—are grouped by type, use, and quantity. Materials that are waste are classified as those from internal sources and those from external sources. Energy indicators are divided into direct energy use, segmented by primary source, and indirect energy use. These measures would be useful as part of cost reduction in the BSC financial perspective. The environmental indicators are also relevant from the BSC internal business processes perspective. In particular, innovation is applicable. Companies can reduce their emissions by developing new products and/or processes that emit fewer greenhouse gases and other ozone-depleting substances. The environmental indicators are good measures to ensure that the company is moving to reduce environmental impacts. GRI environmental indicators are also important from a BSC risk management perspective because a company that does not manage its pollution problems faces the risk of fines and lawsuits for environmental damage.

Biodiversity indicators include location and size of land owned, leased, or managed in biodiversity-rich habitats. These indicators also report the effect industrial activity has on the biodiversity in terrestrial, freshwater, and marine environments. Biodiversity indicators are important for the customer perspective of the BSC.

Table 2: Snapshot of Where Balanced Scorecard Perspectives Intersect with Environmental Sustainability Indicators

Environmental Sustainability Indicators†	Balanced Scorecard Perspectives*					
	FINANCIAL		CUSTOMER		INTERNAL BUSINESS PROCESSES	
	Cost Reduction/ Productivity Improvement	Risk Management	Satisfaction, Loyalty	Retention, Acquisition, and Profitability	Innovation	Operations
Materials	✓	✓		✓	✓	
Energy	✓	✓		✓	✓	
Water	✓	✓		✓	✓	
Biodiversity				✓		
Emissions		✓				
Effluents		✓				
Waste	✓	✓			✓	✓
Products and Services	✓		✓			
Compliance	✓	✓				

* Robert S. Kaplan and David P. Norton, *The Balanced Scorecard*, Harvard Business School Press, Boston, Mass., 1996.

† Global Reporting Initiative, *Sustainability Reporting Guidelines*, Boston, Mass., 2002.

Companies that are thoughtful about their growth in environmentally sensitive areas are likely to attract customers who are interested in sustainable practices. This approach to sustainable development provides goodwill for the company.

Total amount of waste by type and destination also is reported. Destination is the method by which waste is treated, such as composting or reuse. Companies are finding cost-effective ways to reuse their waste. By monitoring where their waste goes, companies can also focus on cost reduction and risk management. Canon, for example, uses large quantities of fresh water to clean its lenses during production. To reduce its costs and impact on the environment, the company redesigned its lens washing process to reduce water use and discharges into the environment. The water is now cleaned and reused. Other GRI environmental indicators are significant discharges into water and significant spills of chemicals, oils, and fuels. This information is relevant to cost reduction and risk assessment in the financial perspective of the BSC. In addition, these measures could be useful for internal business processes. Companies can establish processes that are aimed at reducing the chances that spills will occur.

Indicators for products and services include significant environmental impacts of principal products and services, percentage of the weight of products sold that is reclaimable at the end of the products' useful life, and percentage that is actually reclaimed. When companies report these impacts, they are more likely to look for ways to reduce the waste associated with the product at the end of its life. This can reduce costs and, in many instances, meet customers' specific needs. Interface, Inc., for example, is a carpet producer that has used these ideas about environmental impacts of products and services to meet its customers' needs. The company's customers lease its carpets, and, when the carpets need to be replaced, Interface replaces only the worn pieces. Then Interface reworks or composts the worn pieces.

Table 3: Snapshot of Where Balanced Scorecard Components Intersect with Social Sustainability Indicators

Social Sustainability Indicators†	Balanced Scorecard Perspectives*								
	FINANCIAL		CUSTOMER		INTERNAL BUSINESS PROCESSES		LEARNING AND GROWTH		
	Cost Reduction/ Productivity Improvement	Risk Management	Satisfaction, Loyalty	Retention, Acquisition, and Profitability	Operations	Post-Sale Service	Employee Capabilities	Information System Capabilities	Alignment and Empowerment
Labor Practices and Decent Work	✓	✓			✓		✓	✓	✓
Human Rights		✓			✓			✓	
Product Responsibility			✓	✓		✓		✓	

* Robert S. Kaplan and David P. Norton, *The Balanced Scorecard*, Harvard Business School Press, Boston, Mass., 1996.

† Global Reporting Initiative, *Sustainability Reporting Guidelines*, Boston, Mass., 2002.

GRI compliance reports include fines and incidents of noncompliance with all applicable international declarations/conventions/treaties and national, subnational, regional, and local regulations associated with environmental issues. These reports assist companies with their compliance so they can avoid costly fines and negative media attention. In addition, these GRI indicators address cost reduction and risk management in the financial perspective of the BSC.

Social Indicators

The social component of sustainability details an organization's impacts on the social systems within which it operates. Social performance analyzes an organization's impacts on stakeholders at the local, national, and global levels. Social performance indicators are grouped into labor practices and "decent" work, human rights, and product responsibility, as shown in Table 3.

GRI labor practices and decent work indicators are measures related to employment, labor-management relations, health and safety, nondiscrimination, child labor, forced and compulsory labor, training and education, and diversity and opportunity. Employment indicators show, where possible, the breakdown of the workforce by region/country, status (employee/nonemployee), by employment type (full-time/part-time), and by employment contract (indefinite, permanent/fixed-term, or temporary). Net employment creation and average turnover segmented by region/country are reported. High employee turnover can be an indication that the objectives of internal business processes are not being met. Health and safety indicators include the number of accidents and fatalities, and focusing on worker health and safety can reduce costs. Labor practice indicators that cover nondiscrimination policies, child labor policies, and compulsory labor policies are particularly relevant for the financial, internal business processes, and learning and growth perspectives of the BSC. GRI indicators for nondiscrimination, child labor, forced and compulsory labor, diversity, and opportunity are statements of a company's policies to prevent these activities. These indicators can be useful in risk management of the BSC financial perspective. Meanwhile, training and education indicators provide detail about employee training programs at all levels of the company. Training and education are part of the objectives of the BSC learning and growth because they deal with employee morale and productivity. Ultimately, employees who are treated fairly with regard to wages, a decent work environment, and a healthy and safe place to work are likely to be more productive.

Human rights indicators cover community, bribery and corruption, and political contributions. Community indicators are descriptions of policies to manage impacts on communities in areas affected by a company's activities, as well as descriptions of procedures to address this issue, including monitoring systems and results of monitoring. Community indicators can be tied to the internal business processes objective of the BSC because companies can manage their operations better when they know how their activities affect communities in which they are located. Bribery and corruption indicators involve a description of the organization's policy, procedures/management systems, and compliance mechanisms for addressing bribery and corruption. Political contribution indicators are descriptions of policy, procedures/management systems, and compliance mechanisms for managing political lobbying and contributions. They also include the amount of money paid to political parties and institutions whose prime function is to fund political parties or their candidates. In terms of the BSC financial perspective, the bribery and corruption and political contributions indicators are useful for managing risk associated with the prevention of illegal activities on the part of the company.

Customer health and safety indicators, part of product responsibility, include a description of policy for preserving customers' health and safety when they use the company's products and services. This includes the extent to which this policy is visibly stated and applied as well as a description of procedures to address this issue, including monitoring systems and results of monitoring. In addition, descriptions of policy, procedures/management systems, and compliance mechanisms related to product information and labeling are part of this set of indicators. These indicators can be viewed as important from the customer perspective of the BSC, and they intersect specifically with customer satisfaction, loyalty, retention, and profitability.

A Future of Sustainability Reporting

Sustainability reporting is a growing trend that promises to become a competitive edge for many companies. It is proving to be a valuable tool internally and externally, giving management a means of analysis and stakeholders more transparency. By combining economic, environmental, and social indicators across Kaplan and Norton's balanced scorecard, management accountants can produce meaningful financial and nonfinancial sustainability measures that give decision makers a better view of a company's short-term and long-term profitability as well as long-term viability. ■

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