Accounting for the Sustainability Cycle: How the Accounting Profession Can Add Value to Sustainability-Oriented Activities
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Executive Summary

Global interest in sustainability continues to evolve at a rapid pace on a very broad scope, including shifts to integrated reporting and assurance on sustainability reports. This proliferation has occurred largely without adequate representation from the accounting profession in the United States. Accordingly, this paper encourages accountants to become actively engaged across what we refer to as “the sustainability cycle,” which moves from internal sustainability initiatives linked to strategic objectives to stakeholder engagements based in part on formal reporting with assurance. The purpose of this paper is to motivate accounting practitioners to become actively involved in business sustainability and accounting’s role in its evolution. The article informs readers on the current state of sustainability and calls for accounting practitioners to take a lead role in helping to improve sustainability activities within organizations so that they can effectively evolve across the cycle.
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Practicing “business sustainability” can help organizations create greater long-term value. However, the term sustainability brings to mind very different concepts for business professionals and stakeholders (employees, shareholders, customers, suppliers, lawmakers, regulators, the general public, and so forth). Some organizations conduct sustainability efforts in an effort to please specific stakeholders pushing for a “green agenda,” which sometimes leads to the common misconception that sustainability is synonymous with environmental initiatives. However, these efforts rarely sufficiently please such green agenda stakeholders, and they often create problems with other key stakeholder groups (for example, some stakeholders perceive that environmental initiatives and other key issues like job creation, are mutually exclusive).

Instead, we argue that an emphasis on what we call business sustainability—which encompasses a wide array of stakeholder issues, including green agendas—enables organizations to consider multiple stakeholder groups when making decisions to achieve their strategies so that the organization can benefit on a long-term basis.

We believe that sustainability is best understood when it’s connected directly with business strategy and enterprise risk management (ERM) as part of a broader accounting for sustainability cycle.\(^1\)  This perspective positions sustainability as a way to positively affect the organization’s ability to create long-term organizational value.\(^2\) This paper encourages accountants to become actively engaged across what we refer to as “the sustainability cycle,” which moves from internal sustainability initiatives linked to strategic objectives to stakeholder

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\(^1\) To learn more about this linkage, see the COSO white paper, “Demystifying Sustainability Risk: Integrating the Triple Bottom Line into an Enterprise Risk Management Program” by Faris et al. (2013).

engagements based in part on formal reporting with assurance. This paper describes accountants’ role across the sustainability cycle, including how the profession can add value to sustainability-oriented activities.

**Exhibit 1: CPA Roles in the Sustainability Accounting Cycle**

Today’s demanding business environment creates opportunities and risks for organizations to create or lose value quickly. For example, Carnival Cruise Line has suffered from public relations disasters and safety lapses that damaged its brand to a greater extent than likely would have occurred had the company employed the business sustainability approach espoused in this paper. Alternately, Costco creates long-term value by effectively managing key
stakeholders through its consistent strategy application and timely internal and external communications. Such consistency was evidenced by its seamless transition from co-founder Jim Sinegal to the company’s second CEO Craig Jelinek, who has very successfully carried on Costco’s consistent approach to managing key stakeholders. By engaging stakeholders and linking sustainability activities to organizational strategy, management is in a better position to balance stakeholder and shareholder interests concurrently through more efficient processes, increased revenues from products and services, and improved risk management, employee attraction, and loyalty. These outcomes should lead to long-term positive financial outcomes and enhanced shareholder value. A failure to successfully integrate sustainability activities within an organization’s strategy can lead to opportunity costs and harm an organization’s competitiveness and reputation over the long-term. Accountants’ widely-acknowledged expertise and skills in measurement, control, reporting, and assurance place them in an excellent position to help an organization link sustainability activities to strategies using accounting measures, tools, theories, and techniques. Accountants are able to leverage their skills by working with subject matter experts to help better understand how sustainability initiatives link to strategy and financial performance (and indeed many public accounting firms across the globe offer sustainability advisory and assurance engagements using teams that include both accountants and subject matter experts). As such, accounting for sustainability activities provides a significant opportunity for accounting professionals, both those who work within organizations and those who practice public accounting.

Realizing that sustainability issues represent such opportunities or risks underscores the critical role of the accounting profession in connecting various stakeholder issues—or business risks—to measures that convey long-term financial effects. These measures likely will gain the most traction with C-suite executives and boards of directors because they are better able to
understand trade-offs within and across sustainability activities based on how they affect long-term organizational value.

Board, C-Suite, and Investor Effects on Sustainability at U.S. Businesses

The power of the U.S. capital markets, particularly the major stock exchanges, and sell-side analysts, create shareholder demands for sufficient short-term returns that significantly drive strategic decision-making by C-suite executives and boards of directors of public companies. For sustainability-related activities to play a significant role in strategic decision-making, their effectiveness (return on investment) needs to be adequately linked to financial performance and strategy within the organization. These linkages can be made across a number of strategic and financial dimensions, including increased customer satisfaction, reduced material or other supply chain costs, increased market share, improved recruitment and retention of top talent, reduced political costs resulting from regulations, and access to strategic alliances with organizations that align with the values of the organization.

Accounting practitioners, both internal and external to the organization, can provide critical missing accounting measurements by identifying quantitative measures for sustainability activities that can be linked to strategy and financial measures. This linkage is perhaps the most critical determinant of the long-term effectiveness of sustainability-related activities—the so-called business case for sustainability. The Corporate Responsibility Officer’s Association reported in 2010 that only one-third of the companies they surveyed claimed that they could link sustainability activities to the bottom line (see www.theCRO.com); although, this percentage likely has increased as more companies have become more sophisticated regarding the issues and the linkages. Accordingly, while admittedly difficult, accountants have the opportunity to provide significant value to boards of directors and C-suite executives (along with
shareholders) by linking stakeholder issues to sustainability activities through their relative expertise with accounting metrics or other financial and strategic measures of interest.

*The Critical Role of Accounting Throughout the Sustainability Cycle*

While accountants’ expertise should play a critical role in enabling sustainability activities to be conducted effectively, their approach needs to be adjusted somewhat from the one taken in traditional financial reporting endeavors. For example, accounting innovations involving sustainability-related activities as compared with innovations in financial reporting are different in that accounting practitioners involved with the sustainability initiatives likely will need to partner relatively more frequently with subject matter experts in disciplines and arenas most closely associated with the sustainability activities in question. These subject matter experts may include operations personnel, engineers, scientists, government relations, anthropologists, and other internal experts from within organizations and from external organizations that work with the company of interest. The measurement expertise of accountants, especially as it relates to connecting various leading nonfinancial indicators to future financial and strategic results, can improve strategic decision making when coordinating the relevant specific knowledge possessed by these often times diverse subject matter experts.³

Accountants add value for sustainability activities by infusing their measurement expertise throughout the elements of the sustainability cycle. For example, consider the

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³ As an example of accountants’ reputation for expertise in the measurement area, two of the co-authors interviewed 20 organizations of varying sizes ranging from Fortune 20 companies to mid-cap manufacturers regarding accountants’ value in a data analytics paradigm. Consistently organizations asserted that accountants are skilled with questioning minds/professional skepticism and the ability to identify and model operating and financial metrics to understand how operations translate to financial performance. While not all accountants likely are skilled in this area, these skills are heavily emphasized in accounting education, on-going training, and on-the-job experience. Assurance providers also provide additional expertise in operationalizing independence and verifying adherence of measures to established criteria regarding relevance, reliability, and context. Collectively such expertise and skills should place accountants in a competitive advantage to be effective at adding value to organizations within the sustainability cycle.
sustainability activities associated with an organization’s carbon footprint as a prominent environmental issue for organizations across many industries. Results of carbon footprint analyses by sustainability experts within Procter & Gamble showed that by far the highest percentage of energy use (the carbon footprint driver) for its Tide/Ariel detergent brand occurs during consumers’ heating and use of hot water when washing clothes. Therefore, the company developed Coldwater Tide/Ariel Cool Clean detergent to reduce the carbon footprint of its multi-billion dollar brand. Accountants’ skills were useful in helping to link the likelihood that this strategy would lead to a projected increase in sales as part of its overall sustainability products strategy—to generate $50 billion in sales by 2012. Procter & Gamble also used risk management expertise (assessment, control, and so forth) and market research data to manage risks by setting quality and price standards such that consumers do not need to make a tradeoff in quality or price for using its cold water rather than hot water detergents. 4

Further, Puma has made the first attempt to measure value and report the environmental externalities caused by a major corporation and its entire supply chain. As of the year ended December 31, 2010, the company issues an annual environmental profit and loss (EP&L) account (see Puma.com to access an EP&L report). This report calculates the environmental impact for GHG emissions, water use, land use, and air pollution and waste generated through the operations and supply chain of PUMA (valued at 145 Euros in 2010). 5 In addition, sustainablebrands.com reports that the Puma’s EP&L account is a first key step in the development of what they call a “natural capital accounting framework.” Examples like Puma underscore the opportunity for accountants to team with subject matter experts to ensure that

4 Italicized words (strategy, risk management, and the like) refer to the segments of the Sustainability Cycle.
reported information is measured, controlled, and reported consistent with established criteria such that an independent auditor can attest to its relevance, reliability, and context.

Currently, there are a number of available mechanisms for measuring a carbon footprint, ranging from very basic metrics (such as kilowatts consumed converted to tons of emissions) to highly sophisticated processes (for example, organizations like Carbon Trust rely on scientific life cycle analysis techniques to create comprehensive measures of carbon emissions created and used by a product from its inception to decommission). Companies like Procter & Gamble have used life cycle analysis to measure the effects of their products on the environment since the 1980s.

Ensuring that verifiable metrics are in place is becoming more important to organizations for several reasons. First, carbon emissions and reporting are becoming increasingly visible via potential cap and trade, taxation, or use limits being considered or already enacted by the EPA or Congress—similar to steps already being taken in other parts of the world. For example, the AICPA issued Statement of Position (SOP) 13-1, “Attest Engagements on Greenhouse Gas Emissions Information” in April 2013 that requires specific auditing procedures for greenhouse gas statements (see www.aicpa.org to access SOP 13-1).

Second, major retailers might require suppliers to report carbon usage for products sold in their stores. For example, Walmart developed a sustainability index that it plans to require its suppliers to use over the next several years in order to remain or become suppliers for Walmart.° This requirement likely will be accompanied by a need for organizations to

°The following quote was issued within an October 2012 press release available on the company’s website: “By the end of 2017, Walmart will buy 70 percent of the goods it sells in U.S. stores and in U.S. Sam’s Clubs only from suppliers in the United States, China, and around the world who use the Index to evaluate and share the sustainability of their products. This change will involve suppliers who produce goods in categories where the Index is available.”
implement new measurements (and possibly assurance over them since Walmart intends to use them as part of the supplier selection process).

*The AICPA as an Important Influencer Along the Sustainability Cycle*

Organizations should speak with one voice to each of its stakeholder groups to bring together splintered definitions and perspectives under a broad, stakeholder-driven definition of business sustainability, which creates value as stakeholders develop trust in organizations over time. The world’s leading accounting bodies should collaborate (rather than acting in an individual, piecemeal sense) to set established sustainability measurement and reporting criteria in order to convey sufficient credibility to investors, boards of directors, and senior executives. However, this collaborative voice also must address the expectations of a broad group of stakeholders—communities, regulators, politicians, employees, creditors, non-governmental organizations (NGOs), and so forth—which likely necessitates their inclusion in what traditionally have been “accountants-only” standards-setting processes. We believe that accountants are best suited to work across the sustainability cycle because of their unique skills in risk management initiatives, performance metrics, and effectively conveyed reports (with assurance) for both internal and external stakeholders. As the U.S. accounting organization in the best position to participate in the collaboration needed for the single voice, the AICPA and its members should be leaders in this evolution.

There already are a number of sustainability-oriented activities involving international accounting-related bodies that include AICPA participation. These partnerships provide opportunities for AICPA members to become involved in projects at different points on the accounting for sustainability cycle. The AICPA participated in the development of IFAC’s Sustainability framework, and the US-based Enhanced Business Reporting Consortium (EBRC) and the global World Intellectual Capital Initiative (WICI) have greatly benefitted from
involvement of AICPA Director of Business Reporting, Assurance & Advisory Services and XBRL, Amy Pawlicki. In August 2010, The Prince of Wales’ Accounting for Sustainability Project (A4S) and the Global Reporting Initiative (GRI) formed the International Integrated Reporting Committee (IIRC), which includes representatives from the corporate, accounting, securities, regulatory, NGO, and standard-setting sectors. The IIRC is developing an international framework, which is expected to be released in December 2013, to enable “an organization to communicate in a clear, articulate way how it is drawing on all the resources and relationships it utilizes to create and preserve value in a short, medium, and long term, helping investors to manage risks and allocate resources most efficiently.” (www.theiirc.org).

This paper demonstrates how accountants can incorporate these existing and future endeavors into a comprehensive and coordinated approach for long-term business success throughout what we refer to as the Sustainability Cycle. Going forward, there are several areas in which AICPA members can help in evolving the accounting for sustainability cycle. For example, members can work with COSO to have future COSO projects that focus on risk assessment or risk mitigation, as described in the Faris et al. (2013) white paper referenced earlier, to include external risks that involve stakeholder expectations around environmental and social issues. While today’s hot topics include carbon emissions, labor conditions, and job creation, there will continue to be new issues created by stakeholder expectations that threaten organizations’ business objectives and also create opportunities for value creation.

For instance, accountants’ expertise could help avoid these types of problems going forward through implementation of better controls and accounting metrics. For example, the accounting profession is working with both BP and plaintiff attorneys as the company processes

For an excellent description of the evolution from financial reporting to business reporting that provides many insights that are helpful for initiatives involving the accounting for sustainability cycle, see the AICPA Assurance Services Executive Committee white paper “The Shifting Paradigm in Business Reporting and Assurance.”
claims associated with the 2010 Deep-Water Horizon oil rig explosion. A Business Week article by Paul Barrett from June 2013 describes how BP developed a formula based on accounting information to process claims for companies in a five state area potentially affected by the event.

Potential Impediments to Accounting Being Effectively Integrated Into Sustainability

For sustainability activities to be viable at U.S. organizations in the long-run, organizations must become more committed to effectively managing short-term challenges without sacrificing their focus on long-term performance goals. This need for balance is supported by recognizing that stakeholders of the organizations, including at least a subset of shareholders, have expectations that organizations are focused on developing and sustaining value over long horizons. Examples of stakeholders with long-horizon expectations include, but are not limited to, employees, pension fund investors, suppliers, customers, and environmental and social NGOs.

Leaders of U.S. companies have long been accused of being too focused on short-run performance targets to meet earnings or other immediate financial expectations in order to keep share prices high. Accordingly, even if metrics are developed with the help of accountants that link sustainability activities’ effectiveness to financial metrics of value, the reality likely is that certain activities might also have to demonstrate short-term benefits before they receive significant prioritization from executives and boards of directors. This line of reasoning has been referenced often by Walmart in its communications about the immediate cost reduction benefits associated with enhancing the sustainability of its supply chain.

Viewing sustainability activities as a means to appease stakeholder concerns, as opposed to emphasizing strategic or operational benefits from such activities, can result in unintended consequences regarding stakeholder reactions to sustainability reports. Rather than
having value-driven sustainability activities that do not cater to specific stakeholders, organizations instead focus on sustainability activities primarily as a public relations move to meet what they perceive to be expectations by particular stakeholder groups (so-called “greenwashing”). Organizations should avoid this approach for implementing and reporting on sustainability activities and instead focus on a “values-driven” approach that reflects and emphasizes the organization’s long-term core values. A failure to avoid this approach hurts the credibility of the underlying motives for the initiatives and reduces users’ perceptions of the relevance, reliability, or context of information provided. Accountants can work with organizations to help overcome this barrier to organizations realizing the full value potential present in their sustainability efforts.

One explanation for how organizations might unknowingly develop a reputation for greenwashing is that their sustainability reports paint a picture that is too rosy for stakeholders to accept. This result often is fueled by exclusively using public relations firms in developing sustainability reports without also involving public accounting firms to help enhance credibility and independence of the report’s assertions. In contrast, accountants would emphasize greater objectivity, completeness, and transparency than public relations firms, which should reduce perceptions of greenwashing by stakeholders. For example, the Federal Trade Commission issued “green guides” on how to avoid misleading environmental claims in sustainability reports (www.ftc.gov/opa/2012/10/greenguides.shtm).

Using a values-driven emphasis in developing sustainability reports is important because organizations will (and probably should) invest significant resources into activities that have a role in achieving strategic objectives consistent with their core values to increase overall firm

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8 For a more detailed discussion of the value relevance of effective sustainability reporting, see A.T. Kearney’s article: www.smartplanet.com/blog/business-brains/legitimate-sustainability-strategy-could-be-rewarded-by-shareholders/584
value. For example, a 2009 survey by this paper’s co-authors and Crowe Horwath LLP found that 83 percent of the 178 corporate respondents planned to spend about the same (51 percent) or more (32 percent) annually on sustainability-oriented activities during the time since the survey, and these results were positively associated with respondents who reported that they linked sustainability initiatives to strategy. This finding suggests that companies are more likely to invest in sustainability initiatives when they are linked to strategy.

Investments in sustainability activities motivated more by values-driven goals are likely to taper off over time or when economic conditions worsen. For example, when the U.S. economy suffered from 2008-2011, more emphasis was placed on short-term issues rather than longer-term sustainability objectives. As the economy improves, there very well might be a shift back toward an emphasis on longer-term issues. However, sustainability activities that are integrated into an organization’s strategy are much more likely to receive the necessary resources and attention to help organizations meet strategic initiative goals.

**Conclusion: Accountants and Sustainability at a Crossroads**

The growing emphasis placed on sustainability, regardless of how it is defined, is difficult to refute. Organizations should increasingly view business sustainability as the collective set of activities undertaken to achieve long-term value through effective stakeholder engagement. Savvy organizations will continue to seize opportunities to create both short- and long-term value through their sustainability activities. As such, the accounting profession, including members of the AICPA, faces tremendous opportunities along what we term the sustainability cycle to become actively engaged in evolving how organizations make strategic decisions regarding how to account for, report on, and obtain assurance for sustainability activities.

Over the next decade, the role of the accounting profession in sustainability likely will emerge into one of the following two scenarios. One possibility is that the AICPA and the
accounting profession overall will take a leadership position that helps improve the relevance and reliability of sustainability information and the credibility of such information through CPA-provided assurance. Under this scenario, the accounting profession will form meaningful partnerships with sustainability subject matter experts so that optimal reporting and assurance standards are developed. For example, the Global Reporting Initiative (www.globalreporting.org), which has created a set of established criteria for sustainability reporting (the G4 being the most recent set) over the past 15 years and is used by 80 percent of the Global 250 companies, is actively seeking partnership opportunities with the accounting profession with a shared goal of increasing and enhancing measurement, communication, and verification of sustainability information.

An alternate possibility is that the AICPA and the accounting profession overall will fail to take a leadership role while generally accepted reporting and assurance standards are developed by other stakeholder groups, such as NGOs or standard-setting organizations not actively partnering with the accounting profession. Under this very different scenario, the decisions made based on reported sustainability activities will more likely be based on poorer quality information or be made with less confidence because of the lack of independent assurance, or both. As a result, sustainability initiatives within and across organizations—regardless of how they are defined—could falter or fail as C-suite organizational leaders and board members would be unable to adequately understand the ultimate long-term financial effects of their sustainability activities. Capital market participants, as well as the other stakeholder groups, will likely benefit most when the accounting profession serves a key role in standards and practices across the sustainability cycle.